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SERIOUS PROBLEMS CONTINUE IN DEPARTMENT OF DEFENSE SUPPLY SYSTEM

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

MARCH 6, 1990

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SERIOUS PROBLEMS CONTINUE IN DEPARTMENT OF DEFENSE SUPPLY SYSTEM

TUESDAY, MARCH 6, 1990

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 9:35 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senators Glenn, Levin, Sasser, Lieberman, and Roth.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman GLENN. The hearing will be in order.

Today the Governmental Affairs Committee examines serious problems in DOD's management of its $103 billion supply system. This is one of the "high risk" areas identified by both GAO and OMB, and it is not new to this Committee. We have held repeated hearings on these problems.

This stack of reports beside me is a little dangerous. It may fall over and hurt someone, but it goes back for a number of years. It is a partial stack of the reports that GAO has issued on its investigations into the DOD supply system. This does not include the IG reports or other investigations that have been made.

We have been having hearings on DOD supply problems for years ourselves. Back in 1987, to list some of the most recent, we examined the huge growth in useless spare parts and the problems DOD was having accounting for and storing this inventory, ranging from Stinger missiles to nuts and bolts. Some of you attended those hearings, I am sure, and you may recall DOD couldn't locate all the Stinger missiles that were supposedly out there even though they were carefully classified by serial number. DOD spent about 6 months tracking some down in Europe and it finally found they were in the wrong command. We were concerned at that time that the Stinger missiles might be being sold to the Iranians, and might be used against our aircraft. This is one reason that we went into the area. This is just one incident that I happen to recall.

In March of 1988, we reviewed the very serious problem of DOD's loss of control over tens of billions of dollars of property furnished to Government contractors for which there was no record kept. As a result, we didn't accurately know what was in the system at any one time. The billions of dollars of government property furnished to contractors included such mundane things as television sets, computers and vehicles. I remember one day we had the red and

green warning lights they put on top of MP vehicles; we found that they had been overpurchased. You may remember the hearing where we had one of those items here, and DOD had a warehouse full of them in Pennsylvania as I recall. I was told yesterday that DOD had at least a 7 years supply of those warning lights. I thought it was more than that from the earlier testimony.

That was the hearing on inventory control. Then, in 1989, we examined severe problems in the quality of parts purchased by DOD. We heard testimony about aircraft machine gun parts which jammed. The Committee also issued a comprehensive report in December of 1988 on DOD's costly failures to properly manage its inventories. Thus, in the 3 years, we have been interested in not only inventory growth, but also in the loss of control over inventory and the quality of parts purchased.

Now, I particularly don't enjoy taking these tasks on, but as Chairman not only of this Committee but as a member of the Senate Armed Services Committee, I am concerned about how the combat capability this Nation suffers when we have things like this going on. We we are needlessly spending money in certain areas where that money is needed, perhaps, in other areas. I am particularly concerned about that.

Unfortunately, the problems continue, and the conclusions we made in our 1988 report remain equally valid. DOD's tens of billions of dollars in unrequired inventories, unwisely purchased during our build up during the last administration, the Reagan years, continue to grow.

I think much of this has occurred because the people doing the buying and managing the inventory know that their fitness reports, their performance ratings, their promotions, and their future employment, rest on never having to say "not in stock" when a request comes in for a particular part. On the other hand, they are never criticized for overspending or overbuying. And so the tendency is to take the absolute worst case scenario and provide for it because, after all, it is only money, which we can spend. Inventory managers want those items in the bin in case there ever is a request. They never get criticized for having everything in supply.

I appreciate their concern for making sure the supplies are there, but I think the record is replete with examples where we have gone overboard. Warehouses are gorged with the overflow, filled beyond capacity. This stack of GAO reports is only a sample of recent reports on DOD supply management. They discuss the purchase of tens of billions of dollars in unrequired inventories, poor inventory control, inadequate controls over Government material furnished to contractors, lax physical security over inventories, and inadequate assurances that items bought are received before payment is made.

Yet in spite of these past efforts, I am today, in coordination with Senator Sasser as Chairman of the Budget Committee, releasing three more GAO reports presenting more shocking statistics on how DOD manages its supply system. The first report [1]—and these

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[1] "Defense Inventory: Growth in Air Force and Navy Unrequired Aircraft Parts," GAO/NSIAD-90-100, March 1990. For copies send to U.S. General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20877.

reports are available—shows that Air Force and Navy inventory of unrequired aircraft parts grew from $3.5 billion in 1980 to $13 billion in 1988 and now represents about one-third of DOD's aircraft parts inventory. One-third unrequired, is a clear signal that funds are not being wisely spent.

For example, in November 1985 the Air Force bought 73,000 of one item for the F-100. I understand it was for the duct system for the engine which goes on the F-15 and F-16 aircraft. However, the item is being replaced and the Air Force's 41,000 remaining parts, worth about $5 million, far exceed its needs. GAO's second report [1] shows that between 1980 and 1988 unrequired inventories of Navy ship and submarine parts increased from $1.1 billion to $3.7 billion and now comprise 40 percent—I repeat—40 percent of the Navy's ship and submarine parts.

GAO cites an example of the Navy overestimating its needs for amplifiers for radar systems. As a result, 86 of 102 it had on hand were not needed. They had a value of $780,000. GAO's third report [2] evaluates the Defense Logistics Agency, DLA's efforts to terminate unneeded orders, concluding that at least $204 million, or 30 percent, may no longer be needed. It appears the managers are not canceling unneeded orders. Thus, we can expect these items will end up sitting in DOD warehouses for years or be disposed of at a small fraction of their original cost.

What is particularly troubling in this report is that inventory managers are artificially inflating requirements so that items are not identified as overstocked. For example, GAO found that an inventory manager increased the requirement for shirts, a common item, from a 6 month to a 5 year supply, "to avoid having the item appear on potential excess reports." The outcome was that DLA had 379,000 shirts on hand, 1,078,000 on order to meet a requirement for 424,000 shirts. So all the problems are not with F-15s and B-2s and battleships and carriers, they are with common items, too. The excess shirts represented almost a 7-year supply valued at $8.7 million.

The issue is not new. Last April, almost a year ago, I wrote to the Air Force about allegations that inventory managers were told to artificially increase spare parts requirements to eliminate unneeded orders. In other words, they had overordered, and to justify the overorders they wanted their people to increase the requirements. Let me quote to you from an Air Force internal document which happened to come to our attention which said and I quote, "When this inventory report is prepared and the assets moved from potential DOD excess to the requirements segment, do you think anyone [Senator Glenn] may ask why?"

We are asking why. What is disturbing from the GAO report is that this practice seems more widespread than just the Air Force. It has been done too many times and it has been done across the services. When will this stop? How much longer can we expect the taxpayers to put up with continued waste and mismanagement

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[1] "Defense Inventory: Growth in Ship and Submarine Parts," GAO/NSIAD-90-111, March 1990. For copies send to U.S. General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20877.

[2] "Defense Inventory: Defense Logistics Agency's Excess Materiel on Order," GAO/NSIAD-90-105, March 1990. For copies send to U.S. General Accounting Office, P.O. Box 6015, Gaithersburg, MD 20877.

such as this? It is time to take decisive corrective action to solve these problems.

We have almost completed 3 years of looking into DOD supply management, as I indicated starting out, and I think it is time that DOD comes to grips with the problems. Also, as a result of the reduced threat in Eastern Europe and resulting force structure reductions, common sense solutions to managing the inventory and purchases should be followed. As the demand for spare parts are reduced, DOD must today reduce its purchases. Given the future uncertainties, DOD should act to limit purchasing to smaller quantities until the future need is better defined.

Recently OMB and GAO published lists of "high risk" areas which show very clearly the continuing vulnerability of the Federal Government to fraud, waste and mismanagement. The Comptroller General testified before this Committee that agencies know what their major problems are, but too often do not take the actions needed to correct them; thus the problems remain and frequently worsen. This is certainly the case in the testimony that we will hear today.

[Chairman Glenn's prepared statement follows:]

PREPARED STATEMENT OF SENATOR GLENN

Today, the Governmental Affairs Committee examines serious problems in DOD's management of its $103 billion supply system. This is a "high risk" area identified by both the GAO and OMB, but it is not new to this Committee. We have held repeated hearings on these problems. In October 1987, we examined the huge growth in useless spare parts inventory, and the problems DOD was having accounting for and storing this inventory, ranging from Stinger missiles to nuts and bolts. In March 1988, we reviewed the very serious problem of DOD's loss of control over tens of billions of dollars of property furnished to government contractors, including television sets, computers, and vehicles. Finally, in April 1989, we examined severe problems in the quality of parts purchased by DOD. We heard testimony about aircraft machine gun parts which jammed the guns. The Committee also issued a comprehensive report in December 1988 on DOD's costly failure to properly manage its inventories.

Unfortunately, the problems continue and the conclusions we made in our 1988 report remain equally valid. DOD's tens of billions of dollars in unrequired inventories, unwisely purchased during the Reagan years, continue to grow. Its warehouses are gorged with the overflow and are filled beyond capacity. This stack of GAO reports is only a sample of recent reports on DOD supply management. They discuss the purchase of tens of billions of dollars in unrequired inventories; poor inventory control; inadequate controls over Government material furnished to contractors; lax physical security over inventories; and inadequate assurances that items bought are received before payment is made.

Yet, in spite of these past efforts, I am today, in coordination with Senator Sasser as Chairman of the Budget Committee, releasing three more GAO reports presenting more shocking statistics on how DOD manages its supply system. The first report shows that Air Force and Navy inventory of unrequired aircraft parts grew from $3.5 billion in 1980 to $13 billion in 1988 and now represents about one-third of DOD's aircraft parts inventory. This is a clear signal that funds are not being wisely spent. For example, in November 1985, the Air Force bought 73,000 of one item for the F-100 engine, which goes on the F-15 and F-16 aircraft. However, this item is being replaced, and the Air Force's 41,000 remaining parts worth almost $5 million far exceed its needs.

GAO's second report shows that between 1980 and 1988, unrequired inventories of Navy ship and submarine parts increased from $1.1 billion to $3.7 billion and now comprise 40 percent—let me repeat, 40 percent—of the Navy's ship and submarine parts. GAO cites an example of the Navy overestimating its need for amplifiers for a radar system, and, as a result, 86 of the 102 it had on hand were not needed. They had a value of $780,000.

GAO's third report evaluates the Defense Logistics Agency's efforts to terminate unneeded orders, concluding that at least $204 million, or 30 percent, may no longer be needed. It appears that managers are not canceling unneeded orders. Thus, we can expect these items will end up sitting in DOD warehouses for years or be disposed of at a small fraction of their cost. What is particularly troubling in this report is that inventory managers are artificially inflating requirements so that items are not identified as overstocked. For example, GAO found that an inventory manager increased the requirement for shirts from a 6-month to a 5-year supply "to avoid having the item appear on potential excess reports." The outcome was that DLA had 379,000 shirts on hand and 1,078,000 on order to meet a requirement for only 424,000 shirts. The excess shirts represented almost a 7-year supply valued at $8.7 million.

This issue is not new. Last April, I wrote the Air Force about allegations that inventory managers were told to artificially increase spare parts requirements to eliminate unneeded orders. I quoted an Air Force internal document which said that "When this [inventory] report is prepared and the assets move from potential DOD excess to the requirements segment, do you think anyone (Senator Glenn) may ask why?" What is disturbing from the GAO report is that this practice seems more widespread than just the Air Force.

When will this stop? How much longer can we expect the taxpayers of this country to put up with continued waste and mismanagement such as this? It's time to take decisive corrective actions to solve these problems.

As DOD comes to grips with the reduced threat in Eastern Europe and resulting force structure reductions, common sense solutions to managing its inventory and its purchases should be followed. As the demand for spare parts are reduced, DOD must, today, reduce its purchases. Given future uncertainties, DOD should act to limit purchasing to smaller quantities until the future need is better defined.

Recently, OMB and GAO published lists of "high risk" areas which show very clearly the continuing vulnerability of the Federal Government to fraud, waste, and mismanagement. The Comptroller General testified before this Committee that agencies know what their major problems are, but do not take the actions needed to correct them. Thus, the problems remain and frequently worsen. This is certainly the case in the testimony we will hear today.

Chairman GLENN. We have with us today: Panel 1, Frank Conahan, Assistant Comptroller General, National Security and International Affairs Division of the GAO, accompanied by Donna M. Heivilin, Director of Logistics Issues, and Uldis Adamsons, Assistant Director for Logistics Issues.

Panel 2 will be the Honorable Donald J. Atwood, Deputy Secretary of Defense, John A. Betti, Under Secretary of Defense for Acquisition, and Sean O'Keefe, Comptroller, Department of Defense.

Our third panel will be Susan J. Crawford, Inspector General, Department of Defense, accompanied by Robert J. Lieberman, Assistant Inspector General for Analysis and Followup, Department of Defense.

Before we get to our witnesses this morning, I would see if anyone else has any statements. Senator Roth.

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Mr. Chairman, I look forward to hearing from the three panels of witnesses scheduled for today. I will have questions for each of them that hopefully will help us, one, understand better the size and nature of the problems with the Pentagon inventories and financial systems; two, assure that we are addressing the problems; and three, assure that those responsible are identified and held accountable.

The hearing today will address the findings contained in four GAO reports. The first was issued last week and relates to the quality of the Air Force financial information. According to that report, GAO audit work, and I quote, "demonstrates that the Air

Force does not have accurate cost data for almost all of its non-cash assets," end of quote.

Last week this Committee heard from the Comptroller General about this audit. The hearing disclosed that in February the Secretary of Air Force had rejected the findings in the GAO report in a strong letter to the Comptroller General. Despite the position of the Secretary of Air Force, the GAO report has reportedly sparked a major multi-service initiative to develop requirements for a standard accounting system. Deputy Defense Secretary Donald Atwood will address this initiative in his testimony today.

Three new reports are being released this morning. They relate to defense inventories. One deals with the Defense Logistics Agency excess material on order, a second with unrequired aircraft parts stocked by Navy and Air Force, and the third with unrequired ship and submarine parts held by Navy. I know that we can rely on the GAO statement to provide background on these reports, but my reading of them is that the Pentagon has on hand billions of dollars of unrequired parts and supplies and, of course, is spending money every day to maintain them.

There is no way one can dispute the existence of the continuing problem faced by the Pentagon. The problem, in short, is that the Pentagon is paying too much for the part it buys, and even worse, it is buying and maintaining parts it does not need. This problem has, as you have pointed out, Mr. Chairman, been a concern in the past. Back in 1983 when I was Chairman, this Committee took a careful look at the management of the Department of Defense. That examination is documented in a 10-part record which deals with a number of problems that are important here today, including in depth studies of spare part acquisitions, which are particularly germane.

Now, with the changing threat and probable build down of the military with the attendant reduction in budgets, the problem is obviously even greater. How do we explain this waste of limited resources to our taxpayers? Action must be taken to bring this problem under control, and these actions must be taken now.

The only problem I have is that I don't know what value to assign to the problem. GAO's report on the Air Force financial management system's internal controls reports that these are not sufficient to provide adequate and reliable financial information for effective management. And despite this conclusion of inadequacy, GAO then relies on these systems and internal controls to conclude that billions of dollars in unrequired parts are included in the Pentagon's inventory.

While I do not doubt the truth of either statement, I plan to ask GAO just how much credence we can place in the figures reported for inventory values. Perhaps Mr. Conahan can give us a range of values so that we can better assess the size of the problem.

The best face that can be put on this matter is that nothing much has changed. We found in '83 that the Pentagon was paying too much for spare parts. Now we are told that the Pentagon is maintaining inventories we don't need and that the value of these unrequired inventories are increasing.

I look forward to the Pentagon's response to the allegations contained in these reports. In fairness to those who are appearing

before us today, I think we have to say that they inherited this problem and we should be looking with great interest as to how they intend to deal with it. I hope that by the conclusion of today's hearing the Committee will have a sense in some detail of what meaningful actions DOD will take to correct the inventory problems found to exist.

Mr. Chairman, I would ask that we be permitted to submit questions in writing. I also have hearings in the Finance Committee which I hope to attend in part.

Chairman GLENN. Yes, as is customary, we would ask all our witnesses to respond to questions that may come from other members unable to be here or from our review of the record, and ask for it prompt reply so we could include that as part of the record.

Senator Levin?

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Chairman, looking into the Pentagon supply system is like opening the door to Imelda Marcos' closet, you see excess, a staggering excess. The figures that the witnesses will be using today are enormous, billions of dollars in excess supplies.

During the 1980s the Pentagon went on a shopping spree with the taxpayer's charge card, and like a compulsive shopper, bought billions of dollars worth of unrequired items. GAO says we have $34 billion worth of items in the DOD inventory for which there is no current requirement. In other words, excess inventory.

At the hearing an February 23 on the Air Force's financial management system, I asked the Comptroller General how much of the excess inventory of the Air Force, which he estimated to be between $10 billion and $13 billion, would we simply have to write off. He said a good portion. If we take today's $34 billion figure for the entire department and we conservatively estimate that we have to write off only about 1/7th of that, that somehow we can salvage, in other words, 6/7ths of that $34 billion—and I think that is really giving the Pentagon the benefit of the doubt—we would still be losing $5 billion. That is the entire budget of the Environmental Protection Agency. That is the entire budget of our effort to protect our environment, one of our number one priorities, and here we are simply talking about writing off that portion of the excess.

Now, that kind of mismanagement is staggering. It is unacceptable to all of us. Two and a half years ago then Deputy Secretary of Defense William Taft came before this Committee to tell us that everything was going well in the DOD supply system. He highlighted certain initiatives that were underway to reduce inventory growth, and he described them in glowing terms. He told this Committee that, "We are conducting an intensive analysis of all the factors contributing to the inventory growth. Our goal is to identify and take action to limit growth that does not contribute to the modernization, readiness and sustainability of our forces."

Two and a half years ago when Mr. Taft made that pledge to our Committee, DOD inventories were valued at $90 billion. Two and a half years later—today—after that pledge and those promised re-

forms, the DOD inventory has grown—not decreased—grown by $10 billion.

So if the Chairman and members of the Committee sound skeptical in response to DOD's promises today that the supply system is under control and that real changes will be made, this little history I think will help explain why. Major political battles are fought routinely in our Government to bring precious Federal dollars to bear on some of our most serious problems—the environment, education, the war against drugs and crime. Many of us fought hard for just an additional $2 million for EPA's Great Lakes Program Office, an operation to help clean up and protect the Great Lakes. Today we will hear that we simply have to write off billions of dollars in excess inventory because we bought too much too soon because the Pentagon was flush with funds and spending was rewarded over economy.

Getting control over this supply system is imperative, and I look forward to working with you, Mr. Chairman, in your continuing efforts to try to do that, and I commend you on those efforts. You have tried for a very long time to blow the whistle on this excess.

Chairman GLENN. Thank you, Senator Levin. And lest the Air Force think we are picking on them, I would remind everyone here that wasn't here at our previous hearing, the Air Force was picked for this particular audit that was reported a couple of weeks ago because it was thought to be the best managed of the services. So we are continuing, GAO will be looking into the other services also.

Senator Sasser?

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Thank you very much, Mr. Chairman, and I want to begin my very brief comments this morning by again congratulating you, Mr. Chairman, on the leadership that I think you are bringing to this continuing problem. It is a serious problem. The Pentagon, in my judgment, has serious inadequacy in the management of its huge inventory of spare parts. To demonstrate that, today this Committee, the Governmental Affairs Committee, as the Chairman has indicated, is releasing in conjunction with the Senate Budget Committee three new General Accounting Office reports that detail more problems in the Pentagon's inventory management program.

Now, there is no doubt that these problems exist. There is no doubt that they are severe. The Pentagon's own internal audit agencies have described these serious problems. The General Accounting Office in previous studies over a period of years has corroborated the Pentagon's own internal audit agency's observations.

Just last month the Senate Budget Committee released a report of the Budget Committee staff which also went into some substantial detail in this whole matter. We know we have got a problem. We know we need a detailed plan of action. We know we need to stop buying unneeded parts, and we need to find a way to get rid of some of these unneeded items so that we can return at least some margin of the funds that have been expended for these unneeded items to the treasury.

I want to follow on just a moment, if I may, Mr. Chairman, on something Senator Levin had to say. We have to make very serious and very hard choices now in the allocation of the resources of this Government. We allocate resources in one direction and we are taking them away from some other deed which may be very crying indeed. There is a lot of talk about a decaying infrastructure in this country, about educational needs. We are being asked this year to cut $6 billion or $7 billion out of Medicare, cuts off Medicaid, cuts off very, very vital domestic programs. Yet, at the same time we have the administration of Secretary Cheney coming before the Congress saying that we need to increase defense spending by $5 billion or $6 billion or $7 billion more for fiscal year 1991 than we spent in fiscal year 1990.

Now, that proposition is simply unsustainable when you look at the results of these investigations, studies, reports, that come from the General Accounting Office, that come out of the Pentagon itself from their own internal auditors, come from staff reports from various committees.

Mr. Chairman, what we have got to do is try to find a solution, and I look forward to working with you, and I look forward to hearing from our witnesses today, both from the General Accounting Office and from the Department of Defense.

Thank you.

Chairman GLENN. Fine. Senator Lieberman, do you have a statement?

Senator LIEBERMAN. Thank you, Mr. Chairman. I would ask that the statement that I have be printed in the record.

Chairman GLENN. Without objection, the entire statement will be printed in the record.

OPENING STATEMENT OF SENATOR LIEBERMEN

Senator LIEBERMAN. Just very briefly, I agree with all that has been said before here. In addition to the waste of public dollars, these GAO reports on the Defense Department suggest another concern—the fact that information is either not being gathered or not being used. Throughout these reports it appears that agencies of the Defense Department are not gathering all the information they need in order to make the decisions they need to make; and in other cases, when they have the information, they are not using it adequately. This not only leads to problems in the Defense Department, it leads to problems for us here in Congress. Without adequate information, how can we make either policy judgments or decisions about which programs deserve what resources?

For example, one of these studies today says that the Navy doesn't know why it has $1.2 billion of unneeded equipment. Once the Navy receives purchased material it does not keep records justifying its purchasing decisions.

As all the members of this Committee have suggested, we are at a stage in our history where we are scrambling for dollars to meet public needs. In these recent months there is a national feeling that I sense when I return home to Connecticut, a feeling from the people that the changes in Eastern Europe have given us an opportunity to come home and deal with some of our most pressing na-

tional problems. How we now address these problems ultimately may be the standard by which our greatness and goodness as a society is measured.

And to do this we struggle to find $5 million here, $10 million there, for a given drug program or education program. And I must say I can't help but get angry when I see that one of these reports says that the Navy spends $24 million a year just to store items which are probably no longer of any use. Now, that is unacceptable. That is the kind of management that really has to change if we are to do the job we are supposed to be doing.

Thank you, Mr. Chairman.

[The prepared statement of Senator Lieberman follows:]

PREPARED STATEMENT OF SENATOR LIEBERMAN

Mr. Chairman, I thank you for calling this hearing, which gives us an opportunity further to examine the need to strengthen financial systems and other management controls in the Department of Defense. Nearly two weeks ago, this Committee held hearings on a GAO's audit of the Air Force. GAO pointed to serious shortcomings in the Air Force's existing financial systems, which resulted, among other things, in substantially understating tne ture cost of weapons systems. Indeed, the Comptroller General called it a "coincidence" that the Air Force's most accurate cost estimates differed from GAO's figures by only $400 million.

At that hearing, I expressed my fears about what would be uncovered in audits of the Army and Navy. Today we have a preview, and the results are not promising. Again what we see is that the Department's failure to gather or retain information severely handicaps proper decisionmaking—both in the Department and here in Congress. For example, the Navy does not know why it has $1.2 billion of unneeded equipment. GAO found that once the Navy receives purchased materiel, it does not keep records justifying its purchasing decisions. This policy robs the Navy of information necessary for proper inventory management. It also deprives us of information we need to allocate our shrinking Defense money properly.

Today's studies also illustrate that the Air Force is not the only branch of the Defense Department that fails to use existing information to manage resources effectively. For example, even though its computers identify contracts for parts that are on order but may not be needed, the Defense Logistics Agency infrequently terminates these contracts. It does not even perform a cost/benefit analysis to see if termination costs are outweighed by the costs of accepting additional, unneeded materiel.

Mr. Chairman, we simply cannot afford the luxury of failing to manage our defense resources effectively. In an era of shrinking budgets, money spent to buy and store unneeded parts directly threatens both our national security and our ability to address pressing domestic concerns such as the war on drugs, education, health care and child care. For many domestic programs, we struggle to find even an additional $8 or $10 million. Now we find that the Navy alone spends $24 million a year to store and manage items which may be of no use. This is unacceptable.

Nevertheless, Mr. Chairman, I am pleased that the Department recognizes the need for marked improvement in its accounting and other managerial systems. I wish to emphasize that we are not simply picking on Defense. I am sure this Committee will be equally exacting when it comes time to scrutinize the management of other parts of our government. And while I will reserve judgment on the adequacy of the steps the Defense Department is taking, I commend them for taking these first steps and I look forward to the prospect of this Committee, under your leadership, working with them and the GAO to improve the Department's management systems.

Chairman GLENN. Thank you very much.

Frank C. Conahan, Assistant Comptroller General, welcome to the hearing this morning. We look forward to your statement, Mr. Conahan.

TESTIMONY OF FRANK C. CONAHAN, ASSISTANT COMPTROLLER GENERAL, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE,[1] ACCOMPANIED BY DONNA M. HEIVILIN, DIRECTOR, LOGISTICS ISSUES, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, AND ULDIS ADAMSONS, ASSISTANT DIRECTOR, LOGISTICS ISSUES, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

Mr. CONAHAN. Thank you, Mr. Chairman. We appreciate the opportunity to be here. I believe that your opening statement, as well as the statements of the other members of this Committee, point out the seriousness and the long-standing nature of the inventory growth and management problems that we have been faced with throughout this entire decade.

In order to graphically show the growth, I think I would like to go right to the charts that we have over here, Mr. Chairman. The total value of DOD's inventory increased by $60 billion from 1980 to 1988, for a new total of $103 billion.[2] I think it is significant to see that not only did we have the growth in the early years of the 1980s when we did have the really massive defense build up in the budget, but we are also seeing growth towards the latter part of that period as well.

DOD stores supplies for future wars and 24 months or more of peacetime operations. These are referred to as required stocks. Unrequired stocks are those supplies which are above required needs. We found that both required and unrequired stocks are being held for long term use.

Over 90 percent of DOD's increase in inventory occurred in the three areas that are the highest bars on the second chart;[3] the first one there on the left, aircraft components and parts, and then towards the middle of the chart, ship and submarine parts, and then finally construction, industrial and general supplies. Those three grew at a rate much more rapidly than the other, and the ship parts and the aircraft parts grew at about the same rate.

The third chart[4] shows that as of September 30, 1988 about $34 billion of DOD's inventory was in unrequired items. This is a 233 percent increase since 1980. In addition to the costs of this inventory, there are cost, of course, associated with holding it, and much of it is also likely to become obsolete, lost or, indeed, stolen.

Although in our work we found no dominant reason to cause inventory growth, we believe the growth results from a tendency to stock far into the future. This is fostered by a management philosophy that rewards obligating funds and filling orders. There is no corresponding emphasis on economy or efficiency.

I would like to present some additional examples of this from our recent work.

Chairman GLENN. Mr. Conahan, could I interrupt a moment?

Mr. CONAHAN. Sure.

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[1] See p. 51 for Mr. Conahan's prepared statement.
[2] See p. 73.
[3] See p. 74.
[4] See p. 75.

Chairman GLENN. As I understand it, these figures are DOD figures. These are not your assessment of how many spare parts are needed for a generator on a submarine or something like that, these are DOD's own estimates.

Mr. CONAHAN. That is correct, taken from their own words.

Chairman GLENN. Okay.

Mr. CONAHAN. I would like to put forth some examples for purposes of discussion.

The Air Force's required inventory to satisfy the need for aircraft parts beyond the current year has grown more than any other category. It grew from $1.3 billion in 1980 to $6.6 billion in 1988.

DOD and the Air Force plan changes in inventory reporting procedures which may reduce the visibility of unrequired stock and thereby mask problems. This would allow them to reduce their terminations of orders of unneeded items and accumulate more long term stock that it can classify as required.

Because Navy records supporting past decisions were unavailable and/or item managers were not sufficiently familiar with the items, neither GAO nor the Navy was able to determine why 54 of 100 sample items had unrequired stock. For example, the Navy had 53 reactor assemblies for a sonar system; 51, valued at about $160,000, were unrequired.

Neither the item manager nor the branch chief had records or knowledge of why the items were in the "unrequired" category. Eleven of the 100 items in the Navy sample were not only unrequired, but could have been eliminated from the inventory under the defense inactive item program criteria. Another 57 items had little potential for future use. The 57 items either had no users, no demands in the past 2 years, no forecast of demands, or were being replaced. The Navy is spending millions of dollars to manage many items that may never be used. We believe this is partly due to the overly restrictive criteria that must be met before an item manager can consider elimination of an item from the inventory. In this case, Mr. Chairman, the Navy and DOD agree with us and are adjusting the criteria.

We noted cases where the procurement process was not stopped even though managers were notified that the items were not needed. We found this in the services as well as at DLA. At one of DLA's centers, the Construction Supply Center, contracts falling below $25,000 were not even considered for termination due to excess orders. This excluded 98.5 percent of the center's contracts.

Attached to my statement and in the reports that we have provided, there are additional examples of these types of problems. The attachments are summaries of the three reports that are being released today and of work we have underway at your request that we will be reporting on in the near future, Mr. Chairman.

I would like to add that the problem may be greater than indicated by the report of $34 billion of unrequired inventory. There are indications from our work that portions of the $69 billion of inventory shown in the fourth chart that DOD identifies as required may be based on faulty requirements. We have found numerous cases where DOD added or is planning to add unnecessary requirements. For example, the Air Force is considering adding another

year of requirements to its requirements computations to reduce the number of orders it would have to cancel, with the added effect of reducing the amount of inventory reported as unrequired.

As you asked, Mr. Chairman, we are doing more work to analyze DOD's required inventories.

Now, let me turn to what I——

Chairman GLENN. Before we leave that, could you define "secondary inventory," and define the times and so on for required and unrequired stocks?

Mr. CONAHAN. The secondary inventory is the $103 billion that we are talking about. This is referred to as wholesale level inventories. It does not include the inventories that are out with the units who are actually making the repairs and using them at that level. These are in the depots, these are at the air logistics centers, these are at the tank command, the missile command and at that level. These are at the wholesale level, as I said.

Chairman GLENN. Principal items, as I understand it, would include things like aircraft, tanks, ships carriers and so on. Secondary items would be the compressors, turbines, parts, repair parts, spares, things like that; is that correct?

Mr. CONAHAN. For those end items, yes, sir.

Chairman GLENN. Thank you.

Mr. CONAHAN. There is another category out there—not another category, but another volume—another amount of spares that neither the Department of Defense nor ourselves have a good handle on. They are the spares that are out at the unit level, and there is not a good number as to what that is out there.

Let me just turn to what we see as some necessary steps to correcting the problems that we have been discussing. Fundamental to the process is strong leadership and a change in management philosophy. And that is something that I would like to talk a little bit more about as we get into the dialogue. I think that is key.

Also a key element is an agenda that places a greater value on economy and efficiency than exists today. The agenda that I refer to should include a number of items.

A commitment is needed to update the supply system and take advantage of the management innovations and technologies that have taken place over the last 10 years.

Accurate and useful management information should be available to managers. Inaccurate inventory records, coupled with poor physical security, makes DOD's inventories highly vulnerable to theft, diversions, and other abuses. We have made a number of reports in all of those areas to this Committee earlier. The Comptroller General's recent testimony before this Committee on problems in the DOD financial system is one illustration of the need for improvement.

Management incentives should discourage buying unnecessary inventory. Our inventory growth work showed that buying large quantities of future stock is very risky. However, changing this propensity to buy large amounts of inventory will require, as I mentioned earlier, a change in management philosophy. The DOD supply system responds to the operational imperative to fill orders within a specific time frame and to obligate the funds allocated to the supply mission. However, a corresponding emphasis on reduc-

ing costs and promoting economy and efficiency is lacking. DOD needs to change its mind set and introduce a new culture into the way it manages its supply systems. This means both requiring and rewarding efficient management practices while at the same time satisfying customer demands.

Annual goals must be established for reducing existing inventory to minimize the system's overall vulnerability to fraud, waste and abuse. The sheer size of the inventory complicates the management of an already cumbersome system.

These are a few of our broad ideas and require the commitment and involvement of senior defense managers and executives. The specific problem areas we have identified in DOD's supply system cover a wide range of issues including inventory growth, inaccurate records, physical security, outdated computer systems, inadequate control over material and equipment furnished to Government contractors, overflowing warehouses, and unnecessary levels of inventory. I must reiterate that DOD and the services have recently undertaken initiatives that appear to be steps in the right direction.

We will be issuing a report in the next couple of weeks to the Secretary of Defense which summarizes the results of our large body of work on defense inventory management. We trust it will help DOD plan its approach to reforming the supply system. We believe it will complement the Defense Management Report initiatives, and as I said earlier, we will be working with DOD as implementation progresses.

I will be happy, Mr. Chairman, to take any of your questions.

Chairman GLENN. Thank you very much. We will be on the 5 minute early bird rule here.

How much of this do you think, Mr. Conahan, is due to what I mentioned in my opening statement, of people making decisions mainly to protect their jobs—and that is understandable—in that the worst thing that can happen in a supply system like DOD's is to not have a particular part or piece of equipment or spare part on hand if it is needed. No one has been called to task for overspending or overbuying, and so we wind up with people being super protective to make sure that, on their watch, there will never be a part that is asked for that isn't there, and so they tend to overbuy, oversupply. Is that a major factor?

Mr. CONAHAN. I think it is fundamental. I think it is a root cause of the problems that we are seeing and that we have seen over a long period of time. People, indeed, are rewarded when they are able to produce a part that is necessary. We see very little in the way of rewarding people for taking economy measures. As a matter of fact, in the early '80s people were actually assessed on the bases of the level of obligations that they could put out during that period. As I recall, in the mid-1980s we were up close to $30 billion in undefinitized contracts at that time just so that they could get money out there. We don't have that kind of situation today, but we certainly have the same mind set.

Chairman GLENN. We are in a time period when we are going to be reducing somewhat our military forces, we don't have much doubt about that. I think these reductions should be negotiated at Geneva and Vienna perhaps more than they are, more than just announcing unilateral cuts. However, it is more difficult to cut

forces than to build forces where everybody is sharing in the pie and it is just a matter of whose getting what.

Senator Sasser on the Budget Committee has to put down a figure one of these days for what we are going to have as a defense budget. It is going to be a great temptation to use historical buys and spending in cutting the Pentagon's budget. For example, DOD has overspent by a certain amount for unrequired inventories. Thus, he is going to look at this, I'm sure, and say, well, can't we reduce that particular line item by X amount because it has been overpurchased in the past?

I hate to see us reduced to that, but we have gone on for a number of years with all your reports—that big stack I had here awhile ago because people turnover in the Pentagon at a more rapid rate than we might want, these issues don't seem to get addressed.

You indicate, as I understand it, that one-third of the required inventory is excess to current year's operations and wartime requirements combined, and you are saying that the actual figure may be significantly larger than you have reported; is that correct?

Mr. CONAHAN. Yes, Mr. Chairman. Over time some of those reports that you had in your stack right there showed that practices employed by all the services and DLA resulted in errors or inaccuracies in requirements computations. In a report issued about 3 years ago we listed a number of items why this is so.

Item managers disregard material returns and cancellations.

They use inaccurate lead times and duplicate requirements.

They use methodologies for computing initial spare parts that overstate requirements.

They overstate special stock level requirements.

They don't validate equipment authorizations.

And as mentioned in our report today on the Defense Logistics Agency, they indeed don't cancel orders when they know that those items are in an excess capacity.

So yes, I think that we would find that even in the top part of that circle over there we would find items that are not required.

Chairman GLENN. Would making smaller, more frequent buys make any sense? Now, that leads to less efficiency in that you don't get the same per unit costs that you would for a bigger buy, but would we save in the long run, in your opinion, if we made smaller, more frequent purchases?

Mr. CONAHAN. I think it is interesting to note that the Air Force just recently changed the policy in that regard. Their policy was to buy at least one year's supply, and they have now reduced that to 3 months. Yes, the answer to your question is that I think that they should order the number of months that is required, taking into account whatever the economic order quantity is. If that is three months, they should order three months.

Chairman GLENN. We have some items that require a long lead time. What percent would you think would be long lead time items that would require say a couple of years advance order?

Mr. CONAHAN. I don't have that number, but there is some portion in there that require those long lead times.

Chairman GLENN. Recently DOD disposals jumped from approximately $5 billion to $8 billion a year. Should DOD continue to en-

courage disposal of unrequired inventory, or would such actions merely hide the fact that DOD has been and is continuing to purchase more than it needs to?

Mr. CONAHAN. I think that they have to look at the procurement on the one hand, and the disposal on the other hand. There are items that should be retained, but there are items that should be disposed of, and I think that their disposal program should look at this stuff on a case-by-case basis and where it makes sense to get rid of it, but where it doesn't to retain it.

Chairman GLENN. Thank you. My time is up.

Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman.

These figures are DOD figures you said?

Mr. CONAHAN. Yes, sir.

Senator LEVIN. Do they have a list of stocks that are unrequired?

Mr. CONAHAN. There is a listing behind that. You go out to the inventory control point and you can get a listing of the stocks that are in the various categories. There are essentially two categories that break down. You have got the required stocks and you have got the unrequired stocks. The unrequired stocks further break down into subcategories.

Senator LEVIN. So you would be able to gather together, could you, some kind of a printout of that $34 billion list?

Mr. CONAHAN. We could. It would be a big list.

Senator LEVIN. Well, maybe not in one room, but one facility.

Mr. CONAHAN. If you take a look at the report that we issued today on the ship and submarine parts, on page 34 we list the 100 items of unrequired stock that was the subject of this particular report.

Senator LEVIN. And this could be done for all of the inventory?

Mr. CONAHAN. This could be done.

Senator LEVIN. And then would you be able to determine how many items in that inventory are continuing to be purchased, how many of those items are in the 1991 budget request?

Mr. CONAHAN. I wouldn't want to promise to do that job. That would be a really extensive operation.

Senator LEVIN. Could the DOD do that?

Mr. CONAHAN. Yes, the DOD could do that.

Senator LEVIN. Within a month or 2?

Mr. CONAHAN. I am not sure across the board. This is really a very large operation that we are talking about right here, but they should be doing it on a continuing basis.

Senator LEVIN. Well, they should be, but I guess they are not. I mean, the bottom line for us—and the Budget Committee's task has been referred to, and Senator Sasser is here today—we should try to find out what part of this budget request before us is for inventory for items which we already have in surplus.

Is that at a doable job in the next few months? It should be doable, it is kind of unthinkable——

Mr. CONAHAN. Well, it is certainly doable. I don't know whether it is doable in the next few months. I think I would ask you to ask Secretary Atwood.

See, the difficulty here is that this is a demand-based system. Usage rates are determined, and those usage rates are then the

basis for buys for the future. And what you need to do is to go on back and adjust the usage rates for items that have been taken—end items that have been taken out of the inventory, or requirements that have changed.

Now, what we have done for the appropriations committees each year is to review selected accounts, and we have made recommendations for potential reductions. So we could do it on a selected basis. I am not promising to do it across the board.

Senator LEVIN. Would you able to give us a representative sample so that we can say that X percent of the budget request of the DOD, or a range from X percent to Y percent, is for items which we already have in excess? Would you be able to give us a range based on a representative sample?

Mr. CONAHAN. I can give you information. It may not be statistically valid because of the sample size that would have to be done.

Senator LEVIN. Well, that is why I am asking for a range. Could you give us a range?

Mr. CONAHAN. Why don't we see what we can do on that.

Senator LEVIN. That would be very helpful to us, I think, in the budget process.

Now, what percentage of that $34 billion unrequired stock should be written off?

Mr. CONAHAN. Well, certainly something on the order of $10 billion is cited as potential excess by DOD. The four big areas are economic retention stock, which DOD has determined is more economical to retain for future peacetime use rather than satisfying it through future procurement. Based on our work, I would suggest that not all of it can be defended. The parameters there, for example, in the case of DLA, that means spare parts for weapons up to 20 years and for non-weapons up to 10 years. In the services it is around 18 years.

The next category is contingency retention stock that has no predictable demand or quantifiable requirement, and normally would be potentially excess. That is a little over $10 billion. And then finally, the potential excess, itself, which just simply has——

Senator LEVIN. Do you think that total could be $10 billion?

Mr. CONAHAN. Yes.

Senator LEVIN. How much was written off last year by DOD?

Mr. CONAHAN. I think close to $6 billion.

Senator LEVIN. And was some of that sold?

Mr. CONAHAN. I would expect so. Yes, sir.

Senator LEVIN. What did the sales produce?

Mr. CONAHAN. I don't have that information. I could supply it.

Senator LEVIN. Could you provide the information, and can you also try to give us an estimate of the warehousing costs which were saved as a result of whatever that sale number was, and perhaps an estimate as to what savings we could expect in storage costs if we declared a surplus and sold the $10 billion?

Mr. CONAHAN. Yes, sir.

[The information submitted by Mr. Conahan follows:]

According to information provided by the Department of Defense, about $8.3 billion of property was declared excess and about $8.2 billion was disposed of through transfers to other Federal agencies, donations, sales, or expended to scrap during fiscal year 1989.

The proceeds of foreign military sales and the sale of usable property and scrap totaled about $139 million. According to DOD officials, about $80 million of the $139 million was turned over to the U.S. Treasury. The remainder was used to reimburse the services for authorized expenses. The Department does not maintain separate records for secondary item inventories. Therefore, the above amounts include the disposal and sale of property other than excess secondary item inventory.

The Department of Defense estimates warehousing costs to be about 1 percent of the value of the inventory. Using the Department's estimate of 1 percent, the disposal of the $8.2 billion in excess property resulted in avoiding warehousing costs of about $82 million. Because disposable property is continually being identified, the $82 million warehousing costs that were avoided do not represent savings that can be cut from the DOD budget.

Senator LEVIN. Okay. My time is up. Thank you.

Chairman GLENN. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

You indicated in your opening statement, Mr. Conahan, that one of the problems that we face is a culture at the Pentagon, or in the Department of Defense, a culture which demands that they fill orders and obligate the funds. I believe that is paraphrasing generally what you said.

And if I were to make a judgment on it, I would trace at least the modern day origins of this culture back to 1981 and the view that prevailed then that we needed to spend as much money as we could get our hands on as fast and we could at the Department of Defense, embarking on what was essentially a wartime footing when we were not, as a matter of fact, at war. And sort of a concept of devil take the hindmost, let's spend it just as fast as we can and go back to the Congress and get as much as we can every time we go back there.

Now, when you talk about changing the culture and when you talk about a different management philosophy, you talk about strong leadership being needed to do that.

Would you elaborate on that for just a moment for this Committee, the culture that prevails, the management philosophy that prevails that produces these enormous surpluses of spare parts?

Mr. CONAHAN. I think that your characterization of the early 1980s in terms of a propensity to spend money is in keeping with what our observations were during that period.

As I mentioned earlier when we looked at the early chart, the increases in inventories occurred not only in those years, but they are increasing in the latter years as well. I don't think that we have seen the kind of top level attention and follow through on this problem that is needed to correct these problems. There have been a series of initiatives over a long period of time, but I haven't seen in place the kind of follow-through system that gets down to the people who actually have to take the steps to correct these problems. That is one thing.

The second thing was the matter that we mentioned before. When a person is called upon to produce a part required to keep an end item, a weapons system in place, he or she is looked on favorably when he or she can produce that part. He or she is not called upon, for the most part, to make the decisions which would result in economy and efficiencies.

I ask, if you can produce 95 percent of the time, what is the penalty for producing 93 percent of the time? We don't seem to think in those terms. We think of always having the part ready. So those

two things come together, and I think that is precisely what we are talking about.

Now Secretary Atwood and Secretary Cheney, in coming up with the Defense Management Review initiatives, have in there the kinds of things that I think that are necessary. I think, however, that they are going to have to be implemented and someone is going to have to follow through. Those things are not going to get done unless people follow through on them.

Senator SASSER. Well, you know, with regard to these new initiatives over there, now, we have heard of these time after time after time. And I don't mean to imply that the people of the Department of Defense are venal or that they are deliberately wasteful of the taxpayer's money. I think this is really, as you indicated before, part of the culture that prevails in the Department of Defense, and it is a culture we must reverse.

Let me quote something to you: "Nowhere is cost consciousness more essential than in the military establishment, that vast and complex organism which currently absorbs more than 30 percent of the annual national budget."

That was written in 1949 as part of the conclusion of the first Hoover Commission. Now, we have heard time after time about these improved procurement practices, the management reforms. We have heard on this Committee about the Carlucci initiatives. We have lived through the Grace Commission, the Packard Commission. All of these were excellent studies made by some of the leading experts in this country dealing with these problems, public spirited citizens, many of them donating their own time, and all of them looked for improvements in defense management.

And now we have Secretary Cheney and Secretary Atwood, and I am confident they are well meaning, but they have now the Defense Management Review. And some of us have seen so many of these defense management reviews by other names that we have just simply lost confidence in them.

Is there anything really new about this latest Defense Management Review in your judgment that we haven't seen before?

Mr. CONAHAN. Most of the initiatives look like recommendations that were in that stack of reports that the Chairman had up there. Most of those things were discussed in either previous GAO or DOD IG reports or, indeed, service audit reports. They were covered by the various commissions that you talked about.

There is some effort to associate dollars with those recommendations. I believe in this inventory area that in FY 1991 they attributed $1.3 billion in reductions to this. We will have to see where that goes.

I think, again, I can only reiterate that people have to follow through on these things, they don't get done by themselves. I guess if you think of what we have done here is we have charged, and indeed rely, on our military establishments to sustain a certain condition of readiness. That condition of readiness seems to take the priority over economy and efficiency. Whenever there is a trade-off to be made as to whether to spend an additional dollar for readiness or to take a risk, the additional dollar gets spent.

Senator SASSER. My time has expired.

Chairman GLENN. Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

Mr. Conahan, as I read your testimony, all of the dollar amounts you referred to are investment costs only. Now, if I am correct on that, isn't this just the tip of the iceberg?

Do you have any information on total inventory costs? By this, I mean do you know what the ordering costs are, what the handling costs are? It is my understanding that they are as much as 25 percent or more, so that if this is accurate, the problem is even more significant.

Mr. CONAHAN. We have not validated or verified the amount of handling costs. I think the Department of Defense uses a number very close to the 25 percent, 23 to 25 percent. That includes all handling costs, ordering costs. It also includes a factor for obsolescence.

There are great costs associated with this inventory. I can't quantity it beyond what you have done, sir.

Senator ROTH. But in other words, in your opinion it is very significant, so that the figures we are using, if anything, are underestimated.

Mr. CONAHAN. That is correct.

Senator ROTH. Now, in your testimony you comment on decisions not to terminate orders if there are termination costs.

Do you know whether the termination costs were compared to the cost to handle the inventory in reaching these decisions not to terminate contracts? Or let me put it another way, don't you believe that any savings from avoided termination costs are offset by increased handling costs?

Mr. CONAHAN. It is somewhat distressing the extent to which that good management practice is not complied with. We found cases in the Defense Logistics Agency as well as in the services where the kind of cost-benefit analysis that you are talking about has not been made. We found that extensively. The systems do produce information that a particular item is in an excess capacity and requires the item manager to do the kind of cost-benefit analysis that we are talking about here, and we find all to frequently that after they find out that there is any termination costs associated with it, they simply walk away from it.

Senator ROTH. Now, you spoke about the culture and the bureaucracy, and I subscribe much to what you say. I think there is also a problem up here on the Hill.

Has any study been made to determine to what extent inventories are the result of Congressional action? Isn't it true that Congress often legislates the continuance of procurement when it impacts on a Congressional District or state? That certainly has been true in the case of closing down bases, which is a different area, but it is the same kind of a problem.

To what extent does this appear to be a problem in parts or inventory, or has no study been made in this area?

Mr. CONAHAN. I haven't seen anything done systematically. This occurs, and it does occur for the most part with respect to end items, with respect to weapons systems and other equipment of that nature.

Some of that——

Senator ROTH. Could I just make an observation. If it requires a purchase of end products, doesn't that implicitly mean that parts are going to be bought for that purpose as well.

Mr. CONAHAN. That is correct, yes, sir. So long as they are in the inventory, they have to be supported.

Senator ROTH. So would you care to comment as to whether or not this is a problem?

Mr. CONAHAN. I think it is a problem. I think to the extent—well, let me say this, I am not sure that I can characterize it as a problem.

Senator ROTH. Why not?

Mr. CONAHAN. Well, you people, you know, have your prerogatives and, you know, you can do what you are going to do——

Senator ROTH. Well, wait a minute. Whether it is the Congress or the Executive Branch, I think what we are trying to talk about is an effective procurement policy.

Mr. CONAHAN. I think in those cases where the administration decides that it doesn't need these particular items, then there probably is not much of a requirement for it, because the tendency is to overrequire rather than underrequire. And if they have gotten to that point, they probably don't need much of that stuff.

Senator ROTH. The charge is often made that the Pentagon often utilizes this problem as a means of insuring continued procurement. In other words, if you are buying a major piece of equipment, whether it is a plane or something else, that you procure parts of it from many different states and districts in order to ensure that it has popular support.

Is this a problem?

Mr. CONAHAN. We have seen that there are subcontractors and vendors in many states and districts on individual weapons systems.

Senator ROTH. I guess my basic concern is how do we ensure that the procurement is what is necessary and not a product of culture within the bureaucracy, or political pressures?

Mr. CONAHAN. I think that at the very lowest levels people need to be held accountable for buying only what is required. I think that as you go up through the system people have to be held accountable for the policies that produce the flexibility that these people have out at the very end, and then I think from the very, very top we have to have people say that this is indeed a high priority in this department. It hasn't been. It hasn't had the kind of priority that other items get.

Senator ROTH. Well, I have some additional questions but my time is up, Mr. Chairman.

Chairman GLENN. Thank you. Mr. Conahan, did you run into examples where the requirements were altered to justify an overpurchase? I mentioned that in my opening statement. I had a comment about an excerpt from an internal management memo. It concerns me very much that people would be flat dishonest.

Mr. CONAHAN. We found examples of that.

Chairman GLENN. Is this a major factor? In other words, people, to protect their job, overpurchase to make sure the bin is full for whatever the requirement, full and the cup runneth over, the bin

runneth over, I guess, with parts. In order to justify the overpurchase they then restate the requirement.

How prevalent is this practice and what percentage of the unrequired inventory would come from a practice like this?

Mr. CONAHAN. I can't project to the entire universe. We found it, as I said, both at DLA and in the services. I think the problem is significant enough that we have to take the steps to correct it, but I just simply can't quantify it.

Chairman GLENN. When you pointed out things like this to them, did anyone get called on the carpet, or was it pretty business as usual?

Mr. CONAHAN. We haven't seen people called on the carpet.

Chairman GLENN. Are these buying problems endemic to the whole Government structure? Are other departments, from your experience, having this same kind of problem, but it is only worse in DOD because they have a bigger budget?

Mr. CONAHAN. We have seen similar problems in other agencies that procure these kinds of items. I wouldn't want to make a comparison right now.

Chairman GLENN. Did your audit get into the black programs, the highly classified programs?

Mr. CONAHAN. No, sir, not this body of work.

Chairman GLENN. That is an area that concerns me. Have you looked at any of those in the past? Because, as you know, we have had some of our worst cost overruns in the black programs that were not open to scrutiny until very late in the program. I would presume that their spares and their purchases of spare parts and equipment are probably going to be more than the original purchases. Is that a correct assumption?

Mr. CONAHAN. I think it is a good assumption. We have done very limited work and I wouldn't want to go much beyond that. But yes, you will find the same kind of problems in some of those programs.

Chairman GLENN. One of the problems has been, I might point out, that in recent years we have had a pretty high percentage of our programs classified as black programs——

Mr. CONAHAN. That is correct.

Chairman GLENN [continuing]. That weren't available for close Congressional scrutiny for some time. That is another area we may have to look into one of these days.

That is all I have for now. Senator Sasser?

Senator SASSER. Thank you, Mr. Chairman.

Two questions, really. Mr. Conahan, according to the Pentagon's own reports, most of our warehouses are full now and, according to studies I have seen, we actually are storing some valuable parts out in the open where they are subject to inclement weather. And the Pentagon is saying that—at least we are told—that the warehouses are full now beyond the level of efficient management.

Now, it appears to me this problem is going to get a lot worse. If we are on the verge of bringing 80,000 troops home from Europe, they are going to have to go somewhere if the current round of talks leads to a new treaty with the Soviet Union. And frankly, I think in the not too distant future, particularly if we have an election in Germany in which the Social Democrats win that election,

because of the agreement we made with the Soviets that we will withdraw our troops from Central Europe if we are asked to by the Germans, that we may find more than 80,000 coming home; we could find close to 250,000 coming home very, very fast.

Now, this leads to a problem. It appears likely that we are going to have at least 80,000. I think it is likely we are going to have more than that within the next 2 or 3 years. What are we going to do with all the material that these troops have? Where are we going to put it if all the warehouses are full?

Mr. CONAHAN. I think that we have a problem before us in that regard. As a matter of fact, several years ago the Army found that it had a great deal of excess inventory in Europe. It returned it back to the United States, and the depots here had a really difficult time in trying to handle that material that was returned. The kinds and the levels that you are talking about now associated with that kind of a troop withdrawal is going to be much greater than it was the last time they found themselves in that excess capacity.

Yes, I think that they are going to have difficulties with that and I think we better begin to worry about how we are going to handle that.

Senator SASSER. Now, you said in your opening statement that even though there is evidence within the Department of Defense that procurement of a particular item ought to be stopped, and even though sometimes the purchasers of this item might be instructed to stop purchase, they continue to procure these items. And we see now in the latest Department of Defense budget, even though we have got 6,000 M-1 tanks, even though that tank is designed to be operated on the plains of Western Europe, even though it can't be transported by aircraft—well, you can put one in a C-5—and even though the Pentagon is saying we are terminating the M-1 tank program, when you look at the budget you see that they are continuing to buy about 300 more M-1 tanks to the tune of $2 billion or $3 billion using 1990 funds that somehow they are programming forward to purchase additional tanks in 1991.

Do you have any idea of what we would do with all those M-1 tanks if they are brought home from Europe? Do we have any space to store those if you demobilize two or three of those divisions that utilize those tanks? Any place to put them, to your knowledge?

Mr. CONAHAN. Well, I think we have to decide how that is all going to work. I think that in the multilateral discussions that are occurring right now there is some dialogue as to whether we would indeed bring all those tanks back. And perhaps to the extent that they would stay over there it lessens the problem. When they come back here, I think it is going to be difficult to find places to economically put large quantities of equipment.

I think it is going to be difficult to accommodate people. If we take large numbers of people out of Europe and don't take them out of the force structure, I think we are going to have big problems to contend with.

Senator SASSER. One final question. The General Accounting Office has recently released a report detailing problems that you have encountered in the B-2 bomber program, and the report dis-

cusses how the B–2 program has grown by over $10 billion in 1981 dollars. And the General Accounting Office I think does an excellent job of pointing out issues about the B–2 relating to its cost, schedule, performance, and I think this report, Mr. Chairman, ought to be of considerable interest to us here in the Congress.

But in this era of tight budget constraints and with the world circumstances changing very rapidly, many of us wonder how in the world we can afford to buy a B–2 bomber. And this concern is heightened when we are made aware of the serious and continuing deficiencies in Air Force management that the General Accounting Office has pointed out.

Do you have any evidence that the B–2 program has been managed any better than other Air Force programs?

Mr. CONAHAN. I think that the B–2 program has been managed, in a general sense, like many of the very large programs in this decade. It is a highly concurrent program. Development and initial production is taking place at the same time.

Senator SASSER. When you say "concurrent," you mean we don't fly before we buy; is that right?

Mr. CONAHAN. I mean that we don't have a design before we agree to go forward with production, yes, sir.

Senator SASSER. Well, one final question, because I am running over my time here, Mr. Chairman, but could you just give us your best estimate, if you have one, of how extensive the future cost growth is likely to be in the B–2 bomber program?

Mr. CONAHAN. Well, I think there are a number of things that have to be taken into account. The current estimate is something on the order of $70.2 billion, as I recall. That is a June 1989 estimate. There certainly has been cost growth since then. There has been inflation added to that. Boeing had a strike, there are costs associated with that. So I believe that the Secretary of the Air Force just last week said that the cost is now something on the order of $75 billion.

That cost looks at a spending profile which is very, very high. That requires a funding profile from the Congress of somewhere between $7.5 billion and $8 billion for each of, I believe, the next 5 years. It also requires ordering a very, very large number of aircraft before we have the kind of data that one would hope to have concerning how well it will perform some of its missions. So I think that if it doesn't get that kind of a funding profile, it is going to be much higher, and if they do some of the testing that we think they should do before hand, it is also going to be higher.

Senator SASSER. Thank you, Mr. Conahan.

Chairman GLENN. Thank you. Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

Has your office made a study to determine whether or not it would be more effective to simply throw away or scrap excess items rather than spend more money to handle and maintain them in the hopes of recovering some small amount on the sale of excess? Has any study been made, and if not, would it be feasible or desirable?

Mr. CONAHAN. We could do that, as a matter of fact. We haven't done the kind of study that would permit us to draw conclusions of

the kind that you are looking for, but I think it would be appropriate, as a matter of fact, to do that.

Senator ROTH. Well, I shall be happy to send a letter proposing such a study.

Maybe this is not an appropriate question at this time to you, Mr. Conahan, but obviously as we move down in our defense spending it does create many problems, including the maintenance of adequate industrial-military facilities for the future. Are any studies being made that you are acquainted with as to how to reduce defense spending but at the same time maintaining the nucleus of the facilities that might be necessary if the war did break out?

Mr. CONAHAN. Yes. As a matter of fact, Senator Roth, we have such a study underway right now. We are taking a look at the defense industrial base, what it looks like in terms of future requirements, what modifications that we could possibly make to it. We are looking at economic order quantities in relation to the defense industrial base. We are fairly early on in that study. I would expect that it wouldn't be completed much before the end of this year, but we hope to be able to comment on it at that time.

Senator ROTH. One of the concerns, of course, is the impact that a substantially reduced defense budget would have on the economy, not only nationwide but in regions and specific communities. Would that be part of this study?

Mr. CONAHAN. No, not part of the study that I just mentioned.

Senator ROTH. Okay. Thank you, Mr. Chairman. Thank you, I appreciate your testimony.

Chairman GLENN. Thank you very much, Mr. Conahan. We are going to have to get on to our other witnesses this morning, and I appreciate your testimony. We may have followup questions from other members. As I indicated earlier, we would appreciate your early response.

Our next witnesses are Panel 2, the Honorable Donald J. Atwood, Deputy Secretary of Defense, John A. Betti, Under Secretary of Defense for Acquisition, and Sean O'Keefe, Comptroller, Department of Defense.

Mr. Atwood, Mr. Betti, Mr. O'Keefe, welcome to the hearing this morning. We look forward to your testimony and appreciate your being here.

TESTIMONY OF DONALD J. ATWOOD, DEPUTY SECRETARY OF DEFENSE, DEPARTMENT OF DEFENSE,[1] ACCOMPANIED BY JOHN A. BETTI, UNDER SECRETARY OF DEFENSE FOR ACQUISITION, AND SEAN C. O'KEEFE, COMPTROLLER

Mr. ATWOOD. Thank you, Mr. Chairman. Would you mind if I made a few remarks at the very outset?

Chairman GLENN. Fine. Go ahead and proceed as you see fit.

Mr. ATWOOD. I have a few prepared remarks, but having overheard the discussion earlier, I have a few comments I would like to make.

I am sure everyone recognizes that it was a little less than a year ago when John Betti and I, and then later Sean O'Keefe, came to

[1] See p. 77 for Mr. Atwood's prepared statement.

DOD. The big charge that was given to all of us was to face up to the situation that existed, the perception that the Department of Defense was too large, too complex, too unyielding and too costly to operate and that in fact we should look very seriously at how we would go about improving the efficiency, the effectiveness, and reducing the cost of the total package at the Department of Defense.

The first item on our agenda as a result of this charge was to complete a study, in-house, within the Department, on how we would go about improving management. We submitted that report, now commonly called the DMR, Defense Management Report to the President and discussed it very openly with all members of Congress. I heard Senator Sasser ask the question earlier; what is different about that report from any other report? And I think he referred to the Hoover Commission report from 1949.

That is a legitimate question for anyone to ask. Why is this report any different from other report that has been done? I feel that the big difference is that it was done internal to DOD. It was produced by the people at DOD who are going to implement it This was not some outside agency or outside group of consultants brought in to try to analyze what should be done, and then having done that, they hand the report over to the DOD incumbents and say here, implement this report.

This report was done by DOD people, by people in the Services and by civilians; people who are dedicated to seeing that this report gets implemented.

The study deals with a whole range of issues. First of all, it deals with the fact that many of our major weapons programs, are late, they are overcost, or they have some technical deficiency, or some combination of problems. The report deals with steps that we propose to take to minimize these reports.

Second, the DMR deals with the cost of acquisition. We work with a tremendously large defense industry, and we have many of people who are vitally interested in how we go about buying things, and determining what we buy. We are taking definite recommended, we are steps to reduce the cost, improve the effectiveness of the acquisition.

The report also deals with a major problem of ethics arising principally out of the "ill wind" investigation and the general perception that much of the Department and much of the defense industry is full of corruption. We have taken definitive steps to ensure that wherever that existed, whether it be just a perception or reality, that it be fixed. And finally, the DMR deals at great length with micromanagement; micromanagement of DOD on its contractors and micromanagement of Congress on the Department of Defense.

Specific recommendations were made as a result of the DMR, and during the past 6 months we have been in the process of implementing those recommendations and increasing the number of studies that we need to come up with further definitive actions. I think we have made a lot of progress, but we provided a progress report to you people last January in which we said that beginning in 1991 fiscal year we visualized and did propose as part of our budget that we take out $2.5 billion in our operating expenses, and

forecast that over the next 5 year period we would further reduce the spending at the Department of Defense by nearly $40 billion.

A core part of this whole program is a full review of our automated data processing system, because no organization can be better than the information it is given, and it depends in this day and age on having automated data processing systems which provide to management the detailed information necessary to run the business. We also have a series of major studies going on to standardize, to upgrade, and to develop new software systems where required so that we will have required information. Beyond that, we have a series of other studies that are ongoing.

Those are the general comments I would like to make, but I would like also to address two specific issues raised as a result of the GAO reports. As you know, a GAO report that was recently issued was quite critical of the Air Force's financial management system. The report concluded that there was insufficient control over property and inventory assets, unsupported adjustments, and inaccurate reporting in the Air Force's accounting system.

During this same period some in Congress have expressed great concern regarding a series of findings from older GAO reports on the growth in DOD's inventory, and you have heard just prior to this, further discussion about that growth.

I would like to comment on these two perceptions that I believe to some degree are mistaken. First, a recurring theme in the press accounts of the GAO audit of Air Force is that the Department of Defense has inaccurately reported the cost of weapons system to Congress and to the public. On the contrary, we feel confident of the budgetary data provided to Congress. The data which DOD provides to Congress is specifically collected from numerous financial sources and is compiled in selective acquisition reports. The GAO acknowledges that the data in these reports are accurate. Further, the GAO concludes that our funds control procedures guarantee that spending limits are not exceeded. These two confidences set aside, it does not lessen our responsibility to make our accounting and our financial documents whole and consistent throughout the entire department.

Secondly, we have heard much about $30 billion in excess inventory. Of DOD's roughly $100 billion inventory, $70 billion is projected to be used within the next 2 years, or will be held in reserve in case of war. Of the remaining approximately $30 billion, just over two-thirds of that material is projected to be needed after this 2 year period.

The remaining $9 billion is composed of material that is either obsolete or has been used and cannot be repaired. Thus there is indeed $9 billion in truly excess inventory. Over 90 percent of our inventory supports the high quality forces and the systems that are in today's ready and capable armed forces. Nevertheless, we believe that much can be done to reduce the overall size of this inventory and to streamline our material management process, particularly as we reduce the size of the armed forces.

Let me offer a brief outline of actions being taken to address these problems, and then later, John Betti, who is with me, will answer any of the more detailed questions, because he is heading up much of this activity. We recognize the essential need for large

organizations like the Department of Defense to have effective financial controls and material management. We feel they must be responsive and responsible. I would agree with the GAO that the basic accounting controls in DOD are not up to the standards of those in large private sector organizations. I would agree also that much can be done to improve the effectiveness and efficiency of our material inventory system.

Secretary Cheney and I have been concerned about these issues, as I mentioned earlier, since the day we took office. We have taken a number of steps to address the shortcomings, and because of these and similar concerns, approved a series of initiatives that stem from the DMR, or the Defense Management Report. As I mentioned earlier, a central element in this is the development of a Corporate Information Management system, a data processing system to help us manage more effectively. This initiative provides an integrated approach to information, to produce data that will provide data for common business functions across the Department. This would improve the visibility that the line managers and senior decision makers alike have into the DOD inventory system.

We initiated this program last October. I recently attended a first meeting of an executive level advisory group that we established to help us in resolving the broad management issues, and I think they are doing a tremendous job. Tomorrow the group on financial operations will meet for the first time to devise common standards for meeting the requirements in this area, and early next month the material management group will also be meeting.

We will be extending this effort to other common business functions in the coming months. With respect to inventories, we will talk more about this later in response to your questions, but there are many steps that are currently being taken. We believe that streamlining and reducing the number of sites at which functions are performed will not only save money, but will also increase the efficiency in each of these areas.

Mr. Chairman, I have heard that the GAO plans to conduct audits in the Army and Navy similar to that just recently performed in the Air Force. I suspect the GAO will likely find similar problems in those military departments. We are moving out to correct those problems. I have asked Sean O'Keefe to review the state of the accounting systems of the entire military, and he is going to report to me within the next 2 months on his recommendations as to additional actions needed to address the concerns with those accounting systems.

We have accomplished much, but in my opinion DOD can do much more to improve the management of our Nation's defenses. We could accomplish far more still with the assistance of Congress. As you know, we are submitting a few recommended legislative actions which we believe will assist in taking down some of these barriers.

I thank you for the opportunity to appear before you today. I would like to submit for the record a couple of documents. First, a longer statement that will provide greater detail on these issues,[1]

[1] See p. 77.

and second, a book we use which describes in some detail many of the initiatives we have underway.[1] We believe these initiatives will begin making significant savings in the next few months.

John Betti will talk in greater detail about our programs to strengthen our inventory controls, and Sean O'Keefe is here to address your questions on our initiatives to improve financial management.

Thank you very much, and we would be pleased to entertain any questions you have.

Chairman GLENN. Mr. Betti or Mr. O'Keefe, do you have a statement now, or are you just going to respond to questions?

Mr. BETTI. I think we will just respond to questions. Thank you.

Chairman GLENN. Fine. Mr. Atwood, GAO identified—what I also discussed in my opening statement—that people are promoted and their performance is rated, on whether they can fill a request for a particular part or a particular piece of equipment. In reading your statement submitted to us earlier, you indicated that 39 million requests flow into the system each year, and are met 99 percent of the time.

That is a good record, and when you talk about a military organization and what can happen if a particular part is not there, it is understandable that people want to make sure that those parts are available. But what we are concerned with are all of the overages in these areas where people apparently were just protecting themselves against any possible shortage that might happen on their watch.

How do you instill economy as a promotion requirement or as a requirement for satisfactory job performance?

Mr. ATWOOD. I think that is a legitimate concern. Obviously, when one is dealing with the military in time of emergency, there is no question but one will bend over backwards to make sure that we have sufficient numbers of spare parts.

This same tendency also carries over in peacetime, and there is a culture—I think I heard someone earlier use the term "culture"—within the Department which has built up the need over a period of years to be sure that we are never found wanting. Unfortunately that same culture can then go one step too far in which we buy things just to be doubly sure, or triply sure, or quadruply sure. It is part of the whole cultural change that we have to undertake within the Department to be sure that people are not rewarded solely on whether they have material available or not, but also on the efficiency with which they run their departments.

Chairman GLENN. I know you can't make an analogy to business directly, but maybe you can make some analogy. Ed Cole, who headed General Motors for a long time, was a good friend of mine. We used to visit back and forth and I knew him very well. He used to say that—and I think the figure is correct—that only five nations in the world have a bigger budget than General Motors. That was true at that time. Only five nations in the world have a bigger budget than General Motors. That is an enormous organization.

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[1] See p. 129.

You have requirements in General Motors for making sure that there are adequate spares and so on and you pay in the marketplace if that is not correct, or if your estimates are not correct.

Are some of those systems applicable here? How can we transfer to DOD some of those efficiencies you had to have at General Motors? Orare they not transferable? Are you operating with a different end product here, namely security of the country, and thus there is no transfer ability?

Mr. ATWOOD. With the caveat that in terms of national security bend quite far over to make sure that we have the support required, there still is much that is done within industry, and with due regard to my associate, Mr. Betti, that applies to Ford Motor Company too.

Chairman GLENN. I was going to give him equal billing in a minute.

Mr. ATWOOD. GM hasn't done all the good things. Maybe they did them first, I don't know.

Chairman GLENN. Well, they just happened to have a bigger budget at the time I was talking about.

Mr. ATWOOD. But at any rate, there are many of the same things. If you think, for example, of a production line and the material control manager as the one who is responsible for making sure that as the line progresses there are always enough parts in place, there is a tendency to make sure that he has twice as much material just in case something comes up, or three times as much, because he knows he is going to get reprimanded if they run out of parts, and he will never be reprimanded if he has too many.

Of course, all that has changed, and that is what Ed Cole was referring to, the fact that you must reward this material control manager for having the right amount of parts, just-in-time. That is the catch word in today's business, "just in time," make sure that you have the right amount of parts, that you don't have too many, but that you do have them in the proper amounts.

Chairman GLENN. Mr. Betti, I know that we probably can't work a "just in time" delivery for the military, as we are beginning to do in industry. The Japanese seem to have brought it to their industry and we are in large extent copying it in some of our plants. But let's give Ford equal billing here. What do you think would be transferred to DOD that would help it?

Let me say that, I appreciate the studies, and I know, Mr. Atwood, that your studies are excellent, undoubtedly, and you are going to take action on them I hope. However, I have to quite honestly sit here and take that with a grain of salt, because we have seen study after study after study after study, year after year, and every time we hear, yes, we are going to do it.

Now, maybe somebody like you needs to be at your level in the Pentagon for 10 years instead of whatever time you are planning to here. I'm not sure you would volunteer for that.

Mr. ATWOOD. You might have extended my visit.

Chairman GLENN. But the average department head in Government is only on the job 20 months, 22 months, something like that, and so every time someone comes in they want their own new study. And I don't disagree with the DMR, I think it is excellent, but we have seen studies before and I am trying to grope for what

is applicable here to industry that would apply also to the Defense Department that we haven't looked at.

Is there anything there, Mr. Betti?

Mr. BETTI. Could I try both questions?

Chairman GLENN. Take a crack at both of them.

Mr. BETTI. Okay. On the subject of the DMR, I don't think that you will find much in the DMR that is new or revolutionary. It is really, in a large sense, a compilation of the results of previous studies. But what it does do is put together an implementation plan, and it causes action to happen. I think the thing I see that is probably different—and my tenure here is not long enough to have a very long wheel base—is that we have a lot of people excited about the opportunity of making change now, of making what someone on the panel called a cultural change. I think that it is happening. I think that if we can get the thing moving far enough it will go of its own weight. That is what I saw happening in industry during the '80s. It was difficult to get the change started, but once people really realized that change was possible, then it took on a life of its own.

On the other question of inventories, if I may, I don't think that the problem in the government is significantly different than the problem in industry, except for one particular facet, and that is that in the government we have not yet put the onus of maintaining the inventories efficiently on the managers.

The same thing was apparent in industry over a period of time, and as you correctly point out, I think to a large part of American industry, it is the Japanese that focused our attention on the value, or lack of value, if you will, of inventories. They did it in a fashion that I think was extremely interesting, because it was not just on the dollar value, but emphasis was on the negative impacts that large inventories had on the whole operation—the lack of focus on keeping machines up, of producing quality, et cetera.

Chairman GLENN. At Ford, how did you have a feedback to make sure somebody wasn't buying 20 times more generators than you needed, so you didn't have generators to meet requirements clear out into the 21st Century? There had to be some feedback.

Can we put a feedback system like that in the Department of Defense?

Mr. BETTI. I believe that a similar kind of feedback can be put into the Department of Defense that is not significantly different than what the GAO representative talked about. He talked about management incentives to better manage the inventories where, hopefully, we can find a way of developing in a balance between the ability to have a sustained high fill rate and the cost of maintaining that high fill rate. The one difference here between Government and the commercial sector is that there is more of a premium on making sure that the force is ready, and that is properly so.

But that doesn't mean that the force should be ready at any cost. You have to apply a balance. those are the same kind of judgments that have to be made in industry. As Mr. Atwood pointed out, the man on the line wants to make sure that he is not short a part, so the tendency is to have more parts than are required, and the

same thing is true in DOD here and we just have to find a way of managing it.

Chairman GLENN. Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

First of all, let me publicly thank you and state that I appreciate the willingness of both you, Mr. Atwood, and you, Mr. Betti, to appear before the Congressional Military Reform Caucus where you subjected yourself not only to questions from members of Congress but from those in attendance. I think you have been very willing to be open and to try and meet some of the concern.

One of the things that has bothered me is the point the Chairman made, that I guess for understandable reasons the top management of the Pentagon turns over every 20 months or so, and it is, in a way, a hell of a way to run a ship. I think a private company would have very serious problems as well under those circumstances. Yet no one has come up with any means of insuring that the management will stay the same.

One of my concerns about your DMR is that—and I think it has many goods things in it—but you bring in a new group and we go through another change. It is for that reason I have come to the conclusion that we need a professional civilian procurement core where you have top-notch people dedicated to procurement and who are willing to make that their lifetime career rather than a temporary career, whether it be from civilian life or even from the military. But I won't ask you to comment on that today.

But one of the things, Mr. Atwood, much of what you propose in your statement is based on a consolidated approach throughout the Pentagon as a solution of the problems, and I agree with that. I am also idealistic enough to hope you pull it off. One of the things that bothers me, we have many good people like yourself up before us every few years, and I think they are all sincere and well meaning, and in most cases very competent, but nothing ever happens. That is pretty good from our standpoint because we are able to have these hearings every couple of years and lambast you.

But going back to the DMR, it seems that almost every time we look at how DOD operates we find three distinct ways, the Army, the Navy's way, the Air Force, and it seems to me that even in response to Secretary Cheney's Defense Management Report there is quite a different response from each of the services. So with this experience, how are you going to achieve a single corporate information management approach? Do you have sufficient authority? If not, do you need more?

Are there any statutory provisions that preclude a department-wide solution to common problems? You talked a little bit about micromanagement.

Mr. ATWOOD. You bring up another very valued caution sign because, obviously, over the years there have developed within the department several independent data processing systems, for example, just to use that as one benchmark. One of the earliest challenges we faced was to bring together into one team, people from all of the different services and from within OSD, to put these people in a series of meetings in which they were, first of all, encouraged to participate in a critique of the whole department, not just their systems, and learn to work together to go about problem-

solving. I think this has been imminently successful. Whereas, in the first meeting that I attended, the Air Force group sat in one corner and the Army group sat in another and the Navy in another, and the OSD people sat at another position.

If you go into one of these meetings today, they are all commingled and talking about the issues. It is very difficult to tell particularly if they aren't uniformed, what service they represent, because they are indeed looking at mutual Department of Defense problems. I feel quite confident that we have broken some very serious barriers, almost like the Berlin Wall, if you will.

Now, one thing that you mentioned is the time that it takes to get things done, and that is something that we are addressing very heavily. The events in Europe in the past year have taught us a tremendous lesson, and that is that if the Warsaw Pact countries can adopt democracy, if they can knock down the Berlin Wall, if they can do all the major cultural, social, economic and governmental changes in less than a year that they have done, I don't see why we can't reform DOD in less than a year too. That is the thrust of our whole approach right now.

Senator ROTH. Well, I wish you well, and I do think that never will there be a better time for the kind of reform that is needed as we reduce the military procurement, as we are going to, I think, in excess of what the administration has asked. It both gives an opportunity and a challenge because there are going to be less dollars for essential military purpose.

My time is up, Mr. Chairman, but I appreciate you gentlemen being here.

Chairman GLENN. Senator Sasser?

Senator SASSER. Thank you very much, Mr. Chairman.

If I could just be philosophical for a moment, Mr. Secretary, we were chatting a moment ago about what we learned "just in time" from the Japanese automobile manufacturers. Well, perhaps they learned it from an American economist, but they certainly put it into practice, and we in turn have learned from them.

Now, of course, we can never arrange military parts and military inventory on a "just in time" basis. We have to sacrifice some cost efficiency for having the part there when we need it, there is no question about that. But I think we can make some analogy here between—to use the overworked term today—the culture of the Japanese automobile industry, which we have adopted here, perhaps we can learn from that and look at how other countries handle their procurement practices and handle their inventory practices.

Now, you know, we Americans are sort of new at this military business. We got started in a big way in World War II and couldn't wait to get demobilized afterwards. And then we had to get started in a hurry again for Korea. We seem to go at it in great fits and starts. And I think this very substantial build up that we had at the beginning of the decade of the 1980s is also an example of how we go at handling our military establishment in meeting the threats as we perceive them in great fits and starts, and that is subject, I think, to very, very substantial waste and mismanagement along the way.

But I am coming around to this question. Has anybody seen how the French, for example, might handle their procurement practices? I mean, they have been in this business longer than we have, even before the Napoleonic wars, and I am told that they have got a very small group of individuals that handles their procurement, and that these are professionals and they do a fairly good job of it.

How do the British go about? In other words, what I am saying is that perhaps others may have a solution to this very complex problem and rather than trying to reinvent the wheel, let's look at see what they are doing.

Is there anything going on like that to your knowledge, Mr. Secretary.

Mr. ATWOOD. I am going to let Secretary Betti answer that because I know he has dealt at great extent with the British in particular, and to some extent with the French. Some of the changes they have made are ones which we would not want to make, and some of them lead to difficulties that we wouldn't want to incorporate. On the other hand, we have to learn the good from them.

Mr. BETTI. Senator, I am not aware of a specific study that has to do with looking at the inventory problem or inventory control of other country's systems. However, there was an overall review, which included Congress, of their total procurement systems. I think it was the UK, French and Germans, if I remember correctly, and the results of that study was that they had interesting aspects to them but on an overall basis they were not applicable to DOD.

There are probably things to be learned and we should pursue them, so I am not dismissing the idea. On the other hand, the significant difference in size may make it difficult to transpose their system directly. It just so happens I am having lunch with the number 2 man in the French service today and I will bring up the question directly.

Senator SASSER. Well, I would encourage you to do that, because we may learn some things that are very valuable there that we may then be able to incorporate in our system. We learn so much by trial and error and, of course, they have been in it a pretty good while. Not that they have been as successful as we have in their war capability perhaps, but they may have something to teach us.

Now, here we are in 1990 talking about installing an adequate computer system in the Department of Defense, after having spent $3 trillion in the decade of the 1980s. And gentlemen, I will have to tell you that you are not the first representatives of the Department of Defense that I have heard talk about or discuss installing adequate computer systems in the 13 years that I have been on this Committee, and we have discussed this issue time after time.

One of your predecessors, Paul Thayer, probably was the toughest fellow they had out there and was making some real progress until he got into some personal difficulties and was removed. But sort of the revolving door at the top makes it very, very difficult, and people that you are dealing with on a day-to-day basis, or that your subordinates are dealing with, have been there for 20 or 30 years, and so their modus operandi is very much ingrained, for good or ill.

We keep getting these reports. Now, we cited in our Budget Committee staff report, which I think some folks at DOD are critical of—that is their percentage and I am sure that report is not bullet proof—but I think it does cite some problems. One problem was 80,000 camouflage covers for Army helmets that were lost, they couldn't find them. Then the Army bought another 80,000 camouflage covers for helmets and the original stock was found.

Now, in the overall scheme of things, 80,000 helmet covers really doesn't amount to much, quite frankly, when you are spending $300 billion a year for defense, but it is indicative of a problem. The latest GAO study finds that the Navy cites a case where they lost 300 anchor shackles. They couldn't find them, so they bought more anchor shackles, and after they had repurchased the anchor shackles, then the original anchor shackles were found. Now, you wonder how many of those things are lurking out there in this great establishment.

What really can we do about those kinds of problems? That follows on the Chairman's question. What did you do at GM or Ford? You didn't lose engine blocks and then buy new engine blocks and suddenly find that you had 10,000 engine blocks in stock. What can we do about this?

Mr. ATWOOD. Could I take just a moment and go back to a couple of things that you said earlier.

Senator SASSER. Yes, sir.

Mr. ATWOOD. I wanted to followup on working with the British or the French, because I did spend time with my British counterparts last summer and then again this fall. They have a system, which I don't think is really acceptable here. They have a centralized buying organization without the services being involved. But secondly, and perhaps more importantly, once their budget is approved, they go about it and they have no oversight whatsoever from Parliament. They have a much different system than we do here, and I don't propose that. However, so I want you to know that we are looking at their process and we do talk with them on it.

Secondly, you mentioned computers and the amount of money that is spent. This is not a question of not having adequate computational capability. This is a question of not having integrated software systems in order to determine how many containers we have? We don't have a single software program that tracks all of this information.

You talked about payroll systems. I believe we have about 27 different payroll systems within DOD. It is the system's integration that we are building. We are building systems that all talk to each other, are consolidated and not a series of independent systems. As you can envision, the problem is not basically the computers. I think we have fine computers, we have invested money in advanced technology. We need them to communicate throughout the Department.

Now, as far as individual items are concerned, I will let John Betti talk about that. But you are right, part of the reason that we do things foolishly is that we don't have the data in front of us that tells us, "I have such and such, we shouldn't be ordering more," or "It is in such and such location, it isn't lost." And that is the key to

what we are seeking when we seek to improve our data processing systems. John?

Mr. BETTI. Senator, as you mentioned, in a system as large and complex as ours we are going to be able to find mistakes in the system and in the process, and we have to find ways of having better controls so that a fewer number of those mistakes happen. But I would be willing to bet that you wouldn't find any businessman who would swear that he doesn't lose parts somewhere along the line or that his inventory is always 100 percent proper.

But a little broader issue was raised concerning the turnover in people, and you have heard good stories from a lot of different faces from DOD. I think there is a broader issue, in addition to what is essentially management turnover, and that is the fact that in a lot of these cases problems come up, just like instances you have cited, and somebody decides to fix that particular problem, and they end up patchworking over a symptom which results in another problem.

One good example that came up earlier in the GAO discussion concerned disposal of material and the fact that we now tend to hold on to material longer than we should. That policy was a direct result of, as I understand it, a problem that occurred in the '70s where somebody disposed of something that they later needed and therefore had to buy. When they went out to buy at a later point in time they spent a lot more money than the original purchase cost. So the pendulum swung all the way around.

Now, there is no acceptable reason for that, however, it is understandable. In our system we have tried to fix problems, both Congressionally and within DOD, that have caused new problems to happen, instead of fixing the fundamental system. I was given two good examples, one has to do with the Competition in Contracting Act, which required that large contract procedures be used for a purchase over $25,000. I understand that that has added almost 100 days to our lead time, and each day of lead time involves about $10 million in safety level investment. Every 8 days requires an additional safety day. That adds quite a bit to the inventory. We have to find a way of reducing that lead time and related stocks.

We have about a million small arms that are no longer usable. There is a law on the books that prevents us from disposing of them. There are plenty of problems here to be handled jointly, if you will, through the process, and I think that you can help us in that regard.

Senator SASSER. Well, that may argue in favor of the French system, Mr. Atwood, of not having Congressional oversight of some of these defense matters.

Mr. BETTI. That was his story, not mine.

Mr. ATWOOD. I just didn't want you to think I was arguing against oversight.

Senator SASSER. I see. My time has expired.

Chairman GLENN. Thank you, Senator Sasser.

I would just follow up on the micromanagement issue. I think that on the problems we are pointing out and that have been pointed out for years and years and years, we haven't seen much done about it. There is also not much likelihood that what you consider

micromanagement from this side of the river is going to stop very soon.

Mr. ATWOOD. I appreciate that.

Chairman GLENN. We have to get some of these problems straightened out.

Two of the Air Force fixes, as they were called, to the problems cited in the GAO report on financial management that was before this Committee a couple of weeks ago, were to be, so they said, the Air Force Base Level Accounting and Reporting System, BLARS, and the Air Force Technical Order Management Systems, AFTOMS, as its acronym goes.

Mr. O'Keefe, you canceled both of those programs in order to create a joint service initiative in this area. Can you describe why those programs were canceled?

Mr. O'KEEFE. Yes, sir. Part of what Secretary Atwood just explained is the Corporate Information Management, CIM, initiative. BLARS, the Base Level Accounting Resources System, was an area where Air Force management was looking at functional requirements across the Air Force to divide what data would be required for a standard software package that could be used with the existing hardware. Our conclusion was that if that was a functional requirement to meet that particular objective, then we could expand that application for the Army, the Navy, the Marine Corps and the Defense Agency, if need be.

So we convened a set of groups under what Secretary Atwood just described as the Corporate Information Management initiative to get all of the users involved to define a common set of functional requirements so that we are not duplicating systems. It may yet turn out that BLARS might be exactly the right package to use. But before we move out and obligate funds to proceed with a stand alone Air Force unique kind of system, the CIM approach was to integrate all of those requirements and see if it can be used across the department.

This approach pursues the objective Senator Sasser just mentioned a few minutes ago of why are we buying a lot of computers? And the answer is we have plenty of computers. The problem is how do you integrate all of them and make them perform a common objective? So we have puts BLARS in abeyance for the time being. On the AFTOMS program, we are proceeding modestly to make some incremental improvements, but we have suspended any major, wide-scale procurement of systems until we have identified all those functional requirements for that common user base across the department.

Chairman GLENN. I am concerned, Mr. Atwood, somewhat about the honesty of the numbers we are dealing with, too. For instance, I don't believe you were in the room when I made my opening statement, and I read as part of that opening statement part of an internal Air Force memo that we obtained. And the quote was, "When this inventory report is prepared and the assets moved from potential DOD excess to the 'requirements' segment"—in other words, they were deliberately changing the requirements to match the overbuys—"do you think anyone"—and my name was used—"[Senator Glenn] may ask why?"

That is the end of the quote. These changes we are talking about in this particular case resulted in $600 million moving from unrequired to required stocks. Now, that is just flat dishonesty. I don't know how you deal with that, but it should be dealt with very, very harshly. Now, that is from an internal memo. I am sure other things go on.

We have asked GAO to look into some of these things and they have, but we can't go around changing the requirements, after we made overpurchases, to justify the overpurchases.

Mr. ATWOOD. Well, obviously, I recoil at the prospect of anyone doing that, just as you do, and I am sure Dick Cheney and John Betti and Sean O'Keefe feel exactly the same way. We cannot tolerate that. The only way that I know is to keep a close monitor on things. You need the information available at the proper levels so that you can detect if anything like that is going on. But it is not forgivable for anyone to change requirements just to make up for the fact that they may have overbought. I have no sympathy with anyone who does that.

Chairman GLENN. I am afraid it is being done on occasion.

In March of 1988, almost 2 years ago, Under Secretary Costello promised to establish a financial accounting system for Government owned property which is furnished to contractors, and that was to be done no later than October '89. Yet here we are almost two years later, and the only thing that has happened is that a directive was issued in December 1989 directing the establishment of the system. Not completing it, just directing the establishment. DOD had agreed to the establishment 2 years ago.

Why does it take so long to get even minimal progress of such a basic thing as a financial system to establish some kind of adequate financial controls over these tens of billions of dollars of property furnished to contractors?

Mr. ATWOOD. I don't want to apologize or make excuses, but that predates all three of us here. And number two, Mr. Costello's role was in acquisition, not in financial management. And that is not an excuse, I am just saying that I am unaware of that problem.

Chairman GLENN. I wish we could get continuity of some kind, because we get promised one thing, we rely on it, it doesn't happen, new people come in, make a new study, make new recommendations. I appreciate your sincerity in all the things you are suggesting, but it is really hard for us to rely on any of the figures or the corrective processes that you say are underway, because we have heard that song before, to be quite blunt about it.

Can you tell me when this system will be implemented?

Mr. ATWOOD. Sean.

Chairman GLENN. The one that Mr. Costello promised us 2 years ago.

Mr. O'KEEFE. What we have managed to do here in the fiscal year 1991 budget, Senator, is to form a group responsbile for creating a system and financial incentives to control Government Furnished Material, GFM, in the hands of contractors. That is one of the Defense Management Report initiatives that has been implemented in the budget. I am laboring here to try to find the right source document on it. We handed it to the Committee here a few weeks ago.

The objective is to control the inventory, itself, more closely and reflect it in our accounting system as a asset controlled. We have gone ahead and incorporated a directive, as you suggested, in October of this year, and by 1991 we anticipate seeing the savings associated with that. This is an area that really has been a problem. In pursuit of exactly what you are talking about, the 1991 budget incorporates that initiative and reflects it in the budget as an anticipated savings. So in a sense, the mother of necessity is operative here, the money has been deleted so that the system has got to respond and be more accountable for GFM.

Chairman GLENN. My time is up. Senator Sasser?

Senator SASSER. Thank you, Mr. Chairman. I have got two questions, but let me just say a word, if I may, in behalf of the Competition in Contracting Act which Mr. Betti spoke about a moment ago. That was an effort to get away from sole sourcing, and it had been, I think, the experience of the Congress, and perhaps on recommendations of outside experts, that if we get some competition in the contracting and get away from sole sourcing, we probably would get a more cost efficient purchasing process. So there are two sides to that issue, I might say.

Gentlemen, I think it is imperative that those who do business with the Department of Defense be held to the highest standards. Now, I think it is certainly well and fine defense contractors ought to make a profit. They have got to make a profit to stay in business, and we all understand that. But we have a situation now where the Justice Department has been investing Northrop Corporation. They have made a plea bargain arrangement with Northrop, according to my information, over charges of criminal fraud in defense contracting. And Northrop has pleaded guilty to 34 criminal fraud charges involving a number of weapons systems, and Northrop has agreed to pay $17 million in fines.

Now, while $17 million is one of the largest fines ever assessed to a defense contractor, it is really small in comparison to the billions and billions and billions of dollars of work that Northrop does every year for the Department of Defense.

Now, I am told that there have been numerous allegations of fraud in the work that Northrop has done for the B-2 bomber. In fact, there is a large civil suit seeking $20 billion in damages against Northrop.

Now, the question I am asking you gentlemen is, is the Department of Defense committed to a thorough investigation of Northrop's work on the B-2 bomber, and can you assure this Committee that if allegations of fraud are found to be true, that the Department of Defense will seek full restitution for the costs of these illegal activities?

Mr. ATWOOD. The answer to that is absolutely yes. If there are allegations which prove out to be true, we cannot sit idly by and not see full restitution to the department and to the Government for any penalties or recovery of costs that may have accrued as a result of these activities.

Senator SASSER. It is not just as a result of this one incident, as I am sure you well know. It is a question of establishing a hard and fast precedent so that if other contractors seek to cut corners or perpetrate a fraud on the United States Government that they will

know that there is a very strong and strict penalty to pay and one that may even result in them getting put out of business.

Mr. ATWOOD. I concur with that, and as I mentioned earlier, a major element in our first review was ethics in defense business. It does no good to point out that there may be just a handful, or there may be fewer than a fraction of a percentage of people involved in this. If there is one person, it is one too many, and we in the Department have to stand up and be counted that we will not tolerate one iota of medical conduct, either within the Department or within the industry. And we have to join forces with the Department of Justice to make sure that those who perpetrate such a situation are brought to justice.

Senator SASSER. Good. Thank you.

Thank you, Mr. Chairman.

Chairman GLENN. Thank you, Senator Sasser.

We are moving into a time period where we are very uncertain what our future force structure, and along with it, inventory purchases, will be in the years ahead, including what the 5-year defense plan will look like. Does it make sense to make smaller, more frequent buys where we can, even though that would be slightly less efficient, until we get a little more certainty about where we are going with our defense establishment?

Mr. BETTI. I certainly think that is an idea that has to be reviewed. Clearly, it depends on the individual items, what the turnover is, et cetera. So I think we have to make sure that we are making the right overall judgments on how much inventory we hold versus the economy of buying more.

Chairman GLENN. This would mean we could perhaps make some drawdowns in required inventory, as well as in unrequired inventory.

Mr. BETTI. That is right. That has to be reviewed. It is a question of how rapidly does that inventory turn over, what do we need for readiness? And in a time of drawdown, clearly that is a time that we have to manage very carefully how much we are adding to the inventory if less material is going to be being used. I think we have a good idea.

Chairman GLENN. Will your review process consider that?

Mr. BETTI. We have an overall plan that is being put together, which has been in work for sometime, to determine how we are going to manage inventories, and I believe that is a part of that plan. I will make sure that it is.

Chairman GLENN. GAO's report discusses differences between the Air Force and Navy on how inventory is funded. The Air Force funds aircraft parts through its procurement account, whereas the Navy funds them through stock fund accounts. It appears that one of the DMR initiatives is to establish inventory stock funds.

Could you explain how the department views the benefits and cost savings to result from moves such as that?

Mr. ATWOOD. Surely. Sean, why don't you go ahead and respond.

Mr. O'KEEFE. Sure, Mr. Chairman. The Navy experience that started in the late 1970s for shipboard material, and again when they implemented it for aviation reparables, as they are called, in about 1983–84, has demonstrated approximately a 20 percent reduction in the overall cost of reparable items in the inventory, both

for the cost to repair the item as well as to procure initially, and it also produced a reduction in demand.

So the combination of all three of those has produced some huge savings. The argument internally is whether the Army and the Air Force could achieve comparable savings. Navy savings have been on the order of 20 percent. But clearly anything higher than zero is going to be incentive all by itself.

The second institutional factor, that drove us to the reparable decision is that this initiative established a user-based demand orientation. The individual, or the organization, that is actually consuming the item, is the ultimate user. The user is then responsible for paying for it, as opposed to an "issued free" concept which had existed in the Navy and still exists within the Air Force and the Army. The situation will be changed as a consequence of our FY 1991 budget division, if upheld by the Committee.

So between those two empirical factors that we have seen, the Navy experience as well as just the cultural change in mentality of how parts are consumed and how demand is driven, it seemed to be extremely prudent to move toward that system for funding reparables. We are hoping the pay off is going to be substantial.

Chairman GLENN. The systems we have been looking into, and the GAO has looked into for a number of years, have all been out in the open. We have had a fairly high percentage, a growing percentage through the years, I believe, of our programs that are now in the black area. If we have had problems with overpurchase of spares in open systems, I dread to think what may be occurring in the black areas. Are you looking at those now?

Mr. ATWOOD. Yes, we are. In fact, we are reviewing all of the black programs to make sure that there is no undercurrent of activities similar to what we have been talking about here.

Chairman GLENN. Well, can you give us a report on that at this point?

Mr. ATWOOD. No, I cannot.

Chairman GLENN. Is the problem greater in black programs than it is in open programs?

Mr. ATWOOD. I don't know that, and I have no reason to feel it is worse or better.

Chairman GLENN. Well, ordinarily when things are under wraps and people are not publicly accountable, when it is not out there for people to look at, there is a tendency—as we have found in our nuclear weapons program, which this Committee took on some years ago—to do some wondrous things without them being subject to public scrutiny.

Mr. O'KEEFE. Senator, since this is an open session it is kind of hard to get into the numbers here, but I think you are well aware that the size of the amounts we have got in the so-called compartmented programs is not gigantic. Once we move the B-2 out and a few other things, we are not talking about a huge sum of money relative to the overall size of the defense budget.

Chairman GLENN. Yes, but you are talking about a big "if" there. If we move the B-2 out, and a few things like that, I would agree with you, then we would peel it down to a reasonable program. But the B-2 is not moved out, it is still a black program, technically.

Mr. O'KEEFE. Yes, sir. The second factor is, with the exception of the B–2 and a few others that are in production at this point, most of the items you are seeing within that area are full scale development efforts, certainly not consumers of a lot of spare parts, et cetera. So I am not sure that there is a direct correlation that exists in any of this area.

Chairman GLENN. I am not sure that I have a real feel for what can be done in some of these areas. In the Defense Management Report, the Secretary, said and I quote his words, "We require fundamental shifts, cultural changes, a new culture." Those are generalized terms, and I am not sure how this translates into going back and setting up an incentive system for managers not to overbuy.

How do you change that? When you go back across the river and have lunch and give the first order this afternoon, how are you going to change that kind of culture? How do you do that?

Mr. ATWOOD. I probably won't do it with a single order after lunch.

Chairman GLENN. I wish it was that simple.

Mr. ATWOOD. I think when you talk about a change in culture, you have to talk about a change in the incentives and what drives people to make decisions in one way. And I think you touched on it earlier, either you or Senator Sasser, and that is that the system, the rationale that has driven decisions relative to inventories has been for a long time to make sure there is never a time when we are ever short, and therefore we sometimes overbuy. And the incentive was a disincentive, that if you ever found yourself short then you were severely reprimanded.

Rather than a disincentive, we have to incentivise people to make the right decisions so that in fact they do not overbuy, that they spend the right amount of money. The management weapon you have is a little different in the Government than it is in private industry.

Chairman GLENN. Are there positive incentives as opposed to negative incentives? You can always say, "I am going to fire you if you overpurchase so much."

Are there positive incentives for people?

Mr. ATWOOD. Yes, sir, even within DOD. We have the opportunity for incentive pay, for a bonus. We have the opportunity for promotions. And those are positive incentives that I think we have to do more, informing people that their performance, and their performance along certain guidelines, is going to be the basis of incentive pay and the basis for promotions. Not quite as effective as you have in private industry, but it is there, nevertheless, and we just have to be sure we use it.

Mr. BETTI. I think, Senator, one of the things we are going to have to be careful of is allowing the pendulum to swing the other way. What we are looking for are balanced judgments between having the material there for preparedness and readiness and not having too much and not having excessive costs to maintain inventory. So we are going to have to find a way of incentivising the balanced judgment.

Chairman GLENN. I agree completely that we don't want to see the thing go so far the other way that we are not ready to meet whatever challenges we may need to meet from whatever source,

but I think the pendulum has quite a ways to go before we get there, and we need to make a lot of corrections in the meantime.

We do have another panel and we are going to have to move along. We would appreciate you responding to any questions that other members might have, and we wouldn't want to make you late to your French luncheon today.

Mr. BETTI. Thank you.

Mr. ATWOOD. Thank you, Mr. Chairman.

Chairman GLENN. Thank you very much.

Our next panel is Susan J. Crawford, Inspector General, Department of Defense, accompanied by Robert J. Lieberman, Assistant Inspector General for Analysis and Followup, Department of Defense.

I also would note that I am going to enter into the record two letters, an exchange of letters between myself and Jim McGovern, who was Acting Secretary of the Air Force on April 20, 1989,[1] which detailed some of these same problems then, and his reply to me as of May 10, 1989.[2] These will be entered in the record.

Ms. Crawford, your testimony please.

TESTIMONY OF SUSAN J. CRAWFORD, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, ACCOMPANIED BY ROBERT J. LIEBERMAN, ASSISTANT INSPECTOR GENERAL FOR ANALYSIS AND FOLLOWUP

Ms. CRAWFORD. Good morning, Mr. Chairman and members of the Committee. I am pleased to appear before you today to discuss Department of Defense supply management issues. I am accompanied by the Assistant Inspector General for Analysis and Followup, Mr. Robert Lieberman.

In the interest of time I will merely summarize my written statement, which I request be placed in the record.[3]

Chairman GLENN. Your entire statement will be placed in the record.

Ms. CRAWFORD. Thank you. Supply management is one of the most complex, challenging areas confronting DOD managers. Imbalances in supply system operations can have tremendously costly effects. There can be no more vivid an example of supply system failure than the spectacle of multimillion dollar weapons systems unable to function because of the lack of spare parts or other supplies. At the same time, while maintaining high operational readiness, we simply must avoid buying items that clearly exceed requirements and waste resources.

Over the past several years the Office of the DOD Inspector General and the three military department audit agencies have devoted considerable emphasis to the supply management area. We have maintained extensive coverage of virtually every facet of supply operations at all organizational levels. Since October 1988 the DOD audit organizations have published 139 audit reports on those matters. Collectively, we have 74 audits in progress and 24 others planned for later in fiscal year 1990. Our findings basically corrobo-

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[1] See p. 121.
[2] See p. 124.
[3] See p. 106.

rate the supply management problems discussed in your 1988 report and in the Senate Budget Committee report issued earlier this year.

The growth in inapplicable inventory, the overcrowding in many depots, and the high incidence of inventory reporting errors are indicative of the need for improvement in each aspect of supply operations—requirements determination, cataloging, purchasing, distribution, storage, inventory control and disposal. It is particularly important that top level attention be focused on supply management improvement now, as we move into a period of defense program restructuring and drawdown. Declining demand is likely to cause even more growth in excess inventories in the near term. We need aggressive management action to reverse that trend as soon as possible.

Two recent audit reports from my office are especially pertinent to the problem of excessive long supply. In an audit report entitled "DOD Material Returns Program," issued in September 1989, we reported that wholesale supply managers frequently authorized retail activities to return excess material to wholesale storage depots instead of directing shipment of excess material to meet customer requirements at other locations. The DOD components had developed Service unique, lateral redistribution programs that were not controlled and directed by the wholesale supply managers. Not all excess material was being reported. Excess material was not available to fill urgent requirements of other users, and DOD guidance on issue priority was not being followed.

The lack of a DOD-wide lateral redistribution program caused additional costs in shipping excess material to wholesale depots; additional handling and administrative costs in processing, storing and reporting the material; and delays in filling back-ordered requirements. Excess material was frequently not reported to intermediate support activities and wholesale supply managers. The unreported excess material was not made available to fill other customer requirements.

In another summary report on audits of contract terminations issued in November 1989, we summarized the results of a coordinated series of audits by the Inspector General and the GAO from November 1985 through August of 1988. We concluded that the Services did not have effective processes for making economical contract termination decisions at inventory control points. We also found that the Services did not take advantage of opportunities to use excess assets as Government furnished material.

Mr. Chairman, your invitation letter requested my views on the underlying causes of the growth of unrequired inventories and what actions are needed. There are numerous reasons why inapplicable inventory can grow. These include: one, price increases; two, changes in operating tempo of force structure or force deployment; three, weapons system modernization and phase out of obsolete supplies or systems; four, restrictive disposal policy; five, increased procurement lead times; six, slow turnover; seven, disuse of economic order quantity calculations; eight, other procedural weaknesses; and nine, an imbalanced emphasis and, on customer service. Supply personnel are schooled in the concept of timely service to the customer as the paramount concern. In a military organiza-

tion that is understandable and laudable. However, the message needs to be tempered, especially in peacetime, with an equal concern for economy and efficiency. Inaccurate data and controls affecting procurement decisions are a tenth factor.

As the Department of Defense enters into a period of sustained decline in resources and as the tempo of military operations decreases, the managers of the defense supply system face an enormous challenge. They must manage a shrinking military supply system without jeopardizing operational readiness.

There are no simple solutions or quick fixes to problems that have been identified in the supply system. Many different actions are needed to improve the DOD supply management and to avoid the even larger problems that could beset the system in the future. Since supply system procedures and estimating methodologies are not geared for functioning in an environment of decreasing demand, Congress and the DOD must maintain a close focus on the supply management area, but not overreact. A pell-mell rush to dispose of long supply items, for example, could swamp the disposal apparatus, lead to inadequate demilitarization, degrade management controls, and not result in any appreciable financial gain to the Government.

My specific recommendations are as follows: First, the DOD must provide clear and reasonable guidance concerning the disposal of supply items related to active weapons systems. Second, the DOD must ensure that balanced adequate policy guidance is provided to supply managers and enforced. The guidance must stress the need for economy as well as customer service, and there must be sustained, visible top management commitment to achieving lasting improvements.

Third, the DOD must put greater emphasis on completing the many corrective actions to which it has agreed in GAO and DOD audits. Fourth, the DOD must continue the emphasis on logistics management that is evident in the Defense Management Report implementation initiatives.

I support the DMR initiatives and the numerous other ongoing management improvement projects that address the kinds of problems I have discussed today. The Department must ensure, however, that the streamlining of policy guidance under the DMR initiatives does not create policy gaps in the areas of supply management.

In conclusion, I emphasize my view that there is no substitute for attention and commitment from top DOD managers. We must prudently, actively manage the planned sustained decline in defense resources, or the problems we see today will surely be exacerbated. I will continue to place heavy audit, inspection and followup coverage on this area, and to keep the Congress and DOD fully informed of the results.

Mr. Chairman, that concludes my statement.

Chairman GLENN. Thank you very much. You look into this whole system across the board, and you deal with all different parts of the defense establishment.

How does DOD achieve the culture change that it is talking about? What kind of incentives do you think it could give individ-

uals so they are more conscious about the economy, about overbuying? Are there positive incentives there that it can provide?

Ms. CRAWFORD. Yes, I do, Mr. Chairman. Very clearly, some of them have been discussed today including, the opportunity for bonuses, the opportunity for promotion, and the opportunity for tangible rewards for those who achieve economy in the supply process.

I must also point out the cultural change you are talking about that has to start from the top. The message has to be sent loud and clear from the top all the way down through the ranks in DOD. That kind of message has been lacking.

Chairman GLENN. Let me ask a question about the contracts now being written. First, let me go back a little bit.

We were considering whether we were going to buy carriers about 3 years ago, and we looked into the contracting. The way the contracts had been written it appeared to be more expensive to terminate those projects than to carry them on through. This was largely because the termination costs written into the contracts were extremely protective to the contractor, the shipyards.

Are we still contracting like that, and how widespread is that in the Department of Defense?

Ms. CRAWFORD. Certainly that was a problem several years ago, leading to situations like the one that you just mentioned. The problem has been brought to the attention of DOD managers. I cannot give you a figure on what percentage of our contracts today are written in terms more favorable to the DOD, but I believe the movement is away from overly protective contracts.

Chairman GLENN. Is this a major problem with terminations now where we make excessive buys of spare parts? Is this something we have to correct before we could even hope to correct our inventory imbalances?

Ms. CRAWFORD. Clearly our audit work in the past has indicated that there are times when it is more economical to continue rather than to terminate a contract. In other cases, on a dollar and cents basis it is cheaper to continue the contract, even though those items are excess items.

Chairman GLENN. Do you get into contracting procedures?

Ms. CRAWFORD. We do.

Chairman GLENN. Before a contract is let?

Ms. CRAWFORD. We usually come in after the fact and point out problem areas. Hopefully our findings will be used by the DOD managers to write better contracts in the future.

Chairman GLENN. Would contracting procedures be an area you might consider looking into on a sample basis, because that is what is going to keep us out of problems in the future?

Ms. CRAWFCRD. I think that would be an excellent area for us to look at and we certainly shall do so.

Chairman GLENN. You had excess material at three of the seven Army activities and at all seven Air Force activities you reviewed that was not reported to intermediate support activities and wholesale supply managers. The unreported excess material was not made available to fill other customer requirements. You made recommendations to the Army.

Is that a major problem in that it just doesn't get reported, so people don't know it's there and they go out and buy more material?

Ms. CRAWFORD. I think it is indicative of a large problem that I would put in the category of communications. We have redistribution systems that work very well on the intraservice level. Unfortunately, they are only oriented toward intraservice requirements, not interservice requirements. We have, basically, 4 or 5 semiautonomous supply systems operating within the DOD. I note that one of the DMR initiatives that Secretary Atwood discussed a few moments ago was an organizational consolidation accompanied by automated data processing improvements that would permit the different systems to speak to one another.

One of the other problems we find is that items are still sometimes cataloged differently under these different semiautonomous systems, even though the DOD has been trying to achieve uniform cataloging. Therefore, the particular cataloging description of an item in the Air Force might not match the cataloging description of the same item in the Army. Yet both Services may very well be referring to the same item. We need to enhance the communication regarding the interchangeability of parts within the DOD and within the military departments, as well as the requirements for those items and their, availability as excess stock in any given storage location.

Chairman GLENN. Back to contract terminations for a moment. On page 6 of your testimony you state that the DOD IG auditors reviewed the procedures used by Army and Navy inventory control point managers to decide whether to terminate existing contracts for unneeded spare parts. The GAO reviewed the equivalent procedures used by the Air Force. You further state, "We concluded that the services did not have effective processes for making economical contract termination decisions at inventory control points. Certain inventory control points terminated only 2.4 to 8.6 percent of the value of their excess on-order assets, while the audit showed it would have been more economical to delete from 36 to 78 percent of such assets from contracts."

What kind of followup was made after you discovered that?

Ms. CRAWFORD. The Air Force did develop a cost model following the audit work done by my office in conjunction with the GAO. Based upon that cost model, the Air Force was able to cancel considerably more contracts than they had before. The new cost model was a much more accurate indicator of the advantages and disadvantages of termination. The Army and the Navy have indicated that they are developing the same type of cost model for use in the future. We are actively monitoring the followup in that area.

Chairman GLENN. In your statement also you state, and I quote, "DOD's supply system procedures and estimating methodologies are not geared for functioning in an environment of decreasing demand."

Would you expand a little bit on that, because that is exactly the kind of time period we are probably moving into?

Ms. CRAWFORD. Yes. The DOD calculates requirements based upon historical data. Demand histories are used to project future requirements. Clearly, those requirements are already changing

drastically based upon anticipated drawdowns. If we use demand histories of the past, they would provide inaccurate data to our supply managers for predicting the future supplies that would be necessary.

I believe the DOD needs better organization and guidance right now from the top to the supply managers, communicating the changes in scenarios and the changes in likely demand, so those managers can better and more accurately determine what the future requirements will be.

Chairman GLENN. In your testimony you hit on one of the chief culprits inhibiting DOD's ability to efficiently manage its inventories. That is the mind set that not only do inventory managers have to have all those supplies on hand or they are going to get penalized if someone asks for one that they don't have, but also that it is imperative to obligate and expend 100 percent of budget allocations.

You state, and I agree, that DOD's management systems must provide incentives and rewards for efficiency. Is there anything that gives us hope, any followup you can do where people don't wastefully contract at the end of a budget year?

Ms. CRAWFORD. Yes, I believe that there is hope. I stated that I am encouraged by and optimistic about the existing Defense Management Report initiatives, the DMR, for the reasons that Secretary Atwood discussed earlier this morning. My staff and I are very optimistic that the DMR will result in real improvements.

I would point out that the concepts underlying the DMR initiatives are not brand new. Many of the initiatives contained in the report are ideas brought forward by my office in the past as well as by the GAO. I believe that the initiative to consolidate management systems in the supply area, as I just discussed a moment ago, would go a long way towards providing better use of assets and greater efficiency, as well as greater predictability of what the demands and the needs are within the supply system.

I recognize that the jury is still out, however, on the results of the DMR initiatives. We are tracking them very closely, along with the GAO, and we will continue to track, through our followup mechanisms, the initiation of various programs under the DMR.

Chairman GLENN. You state, and I quote, "A pell-mell rush to dispose of long supply items could swamp the disposal apparatus and not result in any appreciable financial gain to the Government."

Are we moving too fast, and are you concerned with the pace that we are at now? Should we speed up, slow up, what should we do?

Ms. CRAWFORD. Actually, we do not see a pell-mell rush right now. I am simply warning against the urge to go forward too hastily in disposal. We feel that the DOD needs to loosen up the current disposal process somewhat and to show more willingness to dispose of items, but prudent controls must be retained. I believe that the Services need to do a bit more in that area and to find a proper balance. The Navy has volunteered to do a test as part of the DMR initiatives and we will be watching that test very closely.

Chairman GLENN. Have you given that advice to the Secretary of Defense?

Ms. CRAWFORD. Yes. I would point out, Mr. Chairman, that many of the initiatives contained in the DMR were initiatives sponsored by my own organization, as well as by the GAO. The Office of the Inspector General actively participated—before my coming on board as the IG—in developing those initiatives last spring and summer.

Chairman GLENN. How closely do you monitor the black areas, the classified areas?

Ms. CRAWFORD. We have not targeted our work in those programs on secondary items or supply management, since they are integrated into the overall DOD supply systems.

Chairman GLENN. That is area though that you are fully authorized to get into?

Ms. CRAWFORD. Yes, that is correct.

Chairman GLENN. From what you have looked at in that area, do you feel that the parts problems, the spares and so on is comparable to the open programs? Is it better, is it worse, is that a fertile field to look into? What is its status?

Ms. CRAWFORD. I believe it is certainly a fertile field to look into. I really do not have the data to make an informed statement on what problems may exist. It is my hunch, however, that we would find a mirror image of the secondary items management problems in the black area that we currently see in the overall DOD supply area. That is only my intuition at this time, however.

Chairman GLENN. Well, we had such a time getting information on the B-2. I recall when we used to make request after request after request for cost figures and we got only the vaguest kinds of estimates. When we finally started getting firm figures on the B-2 a lot of people around here sort of threw up their hands in horror at what we found had been going on all that time.

I don't know that we really have gone into the spares provision and so on for the B-2 program. I was thinking this morning that it may be an area that we should both be getting into right away, because we may find some additional expenditures that we haven't yet seen, even though the costs of the program are pretty well known.

Ms. CRAWFORD. We would certainly be happy to look into that.

Chairman GLENN. I think that is about all I have. Thank you very much. We appreciate all of you being here this morning and, obviously, we all have a lot of work to do in this area and we look forward to working together with you on doing it.

Thank you very much. The Committee will stand in recess subject to the call of the Chair.

[Whereupon, at 12:20 p.m., the Committee adjourned subject to the call of the Chair.]

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DEFENSE INVENTORY: Problems in Managing Secondary Items

Statement of
Frank C. Conahan
Assistant Comptroller General
National Security and International Affairs
Division

Before the
Committee on Governmental Affairs
United States Senate

I am pleased to be here today to discuss the military services' and the Defense Logistics Agency's (DLA) management of their supply systems. We discussed some problems associated with these systems at a hearing before this Committee in 1987. Although the Department of Defense (DOD) has recently undertaken important initiatives aimed at correcting the problems, I am sorry to report that we do not see a great deal of progress. Indeed, since we last testified, problems have increased to the point where we have identified the defense supply system as 1 of 14 federal programs that are highly vulnerable to fraud, mismanagement, and abuse. You may recall, for example, that we expressed concern in 1987 that $30 billion of DOD's inventory consisted of items for which there was no current requirement. Now that figure has grown to $34 billion.

Because of the limited progress, we will place increased emphasis over the next couple of years on solving the long-standing problems in the defense supply system. Even though we do not have all the answers, we believe our efforts to date show that the way for DOD to correct the problems is through top management leadership, commitment, and a specific agenda for improvement. I am encouraged by the logistics-related defense management initiatives, and I have recently met with Deputy Secretary Atwood and we agreed to keep each other informed as the initiatives proceed.

With this overview, I will now turn to a discussion of some specific problems we have identified in the work you requested on inventory growth, inventory management practices, and what we see as the underlying management problems in the defense supply system.

SIGNIFICANT INVENTORY GROWTH IN SECONDARY ITEMS SINCE 1980

The total value of DOD's inventory increased by $60 billion from 1980 to September 1988, for a new total of $103 billion, as shown

in the first chart. DOD stores supplies for future wars and 24 months or more of peacetime operations. These are referred to as required stocks. Unrequired stocks are those supplies which are above required needs. We found that both required and unrequired stocks are being held for long term use. Over 90 percent of DOD's increase in inventory occurred in the three areas that are the highest bars on the second chart: (1) aircraft components and parts, (2) ship and submarine parts, and (3) construction, industrial, and general supplies. The third chart shows that, as of September 30, 1988, $34 billion of DOD's inventory was in unrequired items, a 233-percent increase since 1980. In addition to the costs of this inventory, there are costs associated with holding it, and much of it is also likely to become obsolete, lost, or stolen.

Although we found no dominant reason that caused inventory growth, we believe the growth results from a tendency to stock far into the future. This is fostered by a management philosophy that rewards obligating funds and filling orders. There is no corresponding emphasis on economy or efficiency. I would like to present some examples of this from our recent work.

-- The Air Force's required inventory to satisfy the need for aircraft parts beyond the current year has grown more than any other category. It grew from $1.3 billion in 1980 to $6.6 billion in 1988 and is now one-third of the Air Force's aircraft parts requirement.

-- DOD and the Air Force plan changes in inventory reporting procedures which may reduce the visibility of unrequired stock, and thereby mask problems. This would allow them to reduce their terminations of orders of unneeded items and accumulate more long term stock, that it can classify as required.

-- Because Navy records supporting past decisions were unavailable and/or item managers were not sufficiently familiar with items, neither GAO nor the Navy were able to determine why 54 of 100 sample items had unrequired stock. For example, the Navy had 53 reactor assemblies for a sonar system. Fifty one, valued at about $160,000, were unrequired. Neither the item manager nor the branch chief had records or knowledge of why the items were in the unrequired category.

-- Eleven of the 100 items in the Navy sample were not only unrequired, but could have been eliminated from the inventory under Defense Inactive Item Program criteria. Another 57 items had little potential for future use. The 57 items either had no users, no demands in the past 2 years, no forecast demands, or were being replaced. The Navy is spending millions of dollars annually to store and manage many items that may never be used. We believe this is partly due to overly restrictive criteria that must be met before an item manager can consider eliminating an item from the inventory. In this case DOD and the Navy agree and are adjusting the criteria.

-- We noted cases where the requisition process was not stopped even though managers were notified before a contract was let that the items were not needed. For example, as of September 30, 1988, DLA reported over $471 million of excess material on order at five of its supply centers. Management procedures exist for identifying and cancelling these orders, but actions were often not taken to cancel them. Managers frequently believed there may be some use for them in the future.

-- At one of DLA's centers, the Construction Supply Center, contracts falling below $25,000 were not even considered for termination due to excess orders. This excluded 98.5 percent of the center's contracts.

Attachments to my statement contain additional examples of these types of problems. These attachments are summaries of the three reports that are being released today and of work we have underway at your request. I would like to add that the problem may be greater than indicated by the reported $34 billion of unrequired inventory. There are indications from our work that portions of the $69 billion of inventory shown in the fourth chart that DOD identifies as required may be based on faulty requirements. We have found numerous cases where DOD added or is planning to add unnecessary requirements. For example, the Air Force is considering adding another year of requirements to its requirements computations to reduce the number of orders it would have to cancel, with the added effect of reducing the amount of inventory reported as unrequired. As you asked, we are doing more work to analyze DOD's required inventories.

CORRECTING THE PROBLEMS

Now let me turn to what we see as some necessary steps to correcting the problems I have been discussing.

Fundamental to this process is strong leadership and a change in management philosophy. A key element is a management agenda that places a greater value on economy and efficiency than exists today. The agenda should include a number of items.

-- A commitment is needed to update the supply system and take advantage of management innovations and technologies that have taken place over the last 10 years.

-- Accurate and useful management information should be available to managers. Inaccurate inventory records, coupled with poor physical security, make DOD's inventories highly vulnerable to theft, diversions, and other abuses. The Comptroller

General's recent testimony before this Committee on problems in DOD financial management systems is one illustration of the need for improvement.

-- Management incentives should discourage buying unnecessary inventory. Our inventory growth work showed that buying large quantities of future stock is very risky. However, changing this propensity to buy large amounts of inventory will require a change in management philosophy. DOD's supply system responds to the operational imperative to fill orders within a specific time frame and to obligate the funds allocated to the supply mission. However, a corresponding emphasis on reducing costs and promoting economy and efficiency is lacking. DOD needs to change its mind-set and introduce a new culture into the way it manages its supply system. This means both requiring and rewarding efficient management practices while satisfying customer demands.

-- Annual goals must be established for reducing existing inventory to minimize the system's overall vulnerability to fraud, waste, and abuse. The sheer size of the inventory complicates the management of an already cumbersome system.

These are a few of our broad ideas and require the commitment and involvement of senior defense managers and executives. The specific problem areas we have identified in DOD's supply system cover a wide range of issues, including inventory growth, inaccurate records, physical security, outdated computer systems, inadequate control over material and equipment furnished to government contractors, overflowing warehouses, and unnecessary levels of inventory. I must reiterate that DOD and services have recently undertaken initiatives that appear to be steps in the right direction.

We will be issuing a report in the next couple of weeks to the Secretary of Defense which summarizes the results of our large body of work on defense inventory management. We hope it will help DOD plan its approach to reforming the supply system. We believe it will complement the Defense Management Report initiatives and, as I said at the outset, we will be working with DOD as implementation progresses. I will be happy to answer any questions you might have.

ATTACHMENT I

ATTACHMENT I

GROWTH IN UNREQUIRED AIR FORCE
AND NAVY AIRCRAFT PARTS

Principal items include such items as aircraft and ships, and secondary items include such minor end items as compressors and turbines and repair parts. DOD categorizes its secondary inventories into six classifications. Two represent current requirements, that is, required stocks held to meet war reserve and peacetime operating requirements over a 24-month period. The remaining four represent unrequired inventory--stocks that are not needed to meet current requirements but are held, in most cases, to satisfy potential future requirements and possible contingencies.

DOD's inventory of aircraft parts grew from $17.3 billion in 1980 to $53.6 billion in 1988. Some the increase was due to unrequired stock. We identified (1) the current and past causes for growth in unrequired stock, (2) DOD actions that could minimize growth in unrequired stock in the future, and (3) growth in required stock inventories that are not needed for wartime or current-year operations.

The inventory of unrequired aircraft parts has increased at a faster rate than required stocks. The Air Force's required stock grew 179 percent and the unrequired stock grew 295 percent, from $2 billion in March 1980 to $7.9 billion in 1988. The Navy's required stock grew 151 percent, and the unrequired stock grew about 240 percent, from $1.5 billion in 1980 to $5.1 billion in 1987.

Among the major causes of unrequired inventory growth for aircraft items, we found procurement management practices contributed to growth in unrequired stock. Moreover, some DOD and Air Force initiatives to improve their reports could reduce visibility over unrequired stock and, consequently, mask the need for management attention. Furthermore, required stocks held to meet other than

ATTACHMENT I

current-year requirements have grown significantly and are more likely to become obsolete or experience declining demand before they are needed.

Direct Causes for Unrequired Stock

Our evaluation of the growth in the unrequired inventories of 51 judgmentally selected secondary aircraft items showed that the most common causes for the growth were overestimated use rates and modifications of aircraft and equipment. Other contributing factors included faster than expected phase-out of older aircraft and decreasing war reserve and safety level requirements. Some of these factors have been the subject of prior reports by GAO and DOD.

Procurement Practices Contribute to Unrequired Stock

We examined 36 items which had recent contracts for replenishment buys where on-order quantities were later identified for potential termination because they were excess to requirements. Air Force guidance tended to discourage terminations. Also, the lack of an effective process to identify and act on potential terminations at one of the Navy's inventory control points also impeded terminations.

For five items the Air Force procured and received the materials sooner than required. This practice results in premature inventory investment and unnecessary holding costs and increased risks that material might become obsolete before it is used.

The Navy procured three consumable items in excess of requirements using DOD's technique for determining the purchase quantity that will result in the lowest total cost. We have previously

recommended that the Navy stop its practice of buying more than that quantity without specific justification because it contributes to the Navy's unrequired stock. DOD, however, disagreed.

Reporting Changes Impede Efforts to Reduce Unrequired Stock

Some Air Force and DOD inventory reporting initiatives may aggravate problems with unrequired stocks. The Air Force temporarily authorized adding items to stock requirements and therefore on-order material that should have been reported as unneeded was not reported. It is also considering adding an additional year of requirements to its system for determining requirements. Similarly, DOD proposed adding a year of requirements to its reporting system, and also requirements for purchases to obtain discounts or ensure parts for the life of a system. According to DOD and Air Force representatives, the actions are intended to recognize that obtaining unrequired assets can be in the government's best interest.

Identifying the reasons for buying unrequired stocks can help prevent unnecessary growth. However, the above changes to reporting criteria would mask the extent of growth. They could also reduce the quantities of unneeded orders eligible for termination.

Increases in Air Force Required Stock Could Cause More Unrequired Stock

The growth in the Air Force's required stock held to meet peacetime requirements beyond the current year may result in continued high levels of unrequired stocks. High levels increase the risk of reduced demand or obsolescence because requirements may decline when end items are phased out or are modified. The inventory

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available to satisfy requirements beyond the current year has grown more than other requirements--from $1.3 billion in 1980 to $6.6 billion in 1988. One-third of the Air Force's required inventory is excess to wartime or current year operations.

Many of the problems contributing to unrequired inventories have also contributed to inventory growth in required stocks beyond current-year needs. Such items could become unrequired inventory.

ATTACHMENT II

ATTACHMENT II

GROWTH IN UNREQUIRED SHIP AND SUBMARINE PARTS

The Navy's inventory of ship and submarine parts increased by 249 percent, from about $2.7 billion in 1980 to about $9.3 billion in 1988. This attachment identifies (1) the major causes for unrequired inventory, (2) opportunities to minimize growth in unrequired stock, and (3) inventory with little potential for future use.

Under the Defense Inactive Item Program, the Navy reviews its inventory once a year to identify inactive items for possible elimination from the inventory. Items are identified as inactive when they have (1) been on the master data file for 7 years, (2) had no demand in the last 2 years, (3) no current requirement, and (4) no current application.

In 1988, 40 percent ($3.7 billion) of the Navy's inventory of ship and submarine parts was unrequired. We sampled the 183,000 items that include such stocks and found that the major causes for the unrequired inventory were requirements that did not materialize, deactivation of older ships, and replacement and phasing out of equipment. However, we could not determine why unrequired inventory exists for over half the sample items, since (1) documents justifying past procurement decisions are not available, (2) the Navy has no record of events affecting the demand for these items, and (3) sometimes the managers are not familiar with the procurement or demand history of their items.

Unrequired inventory can be minimized by ensuring that items being replaced or phased out are not purchased or repaired unnecessarily.

We estimate that 109,000 ship and submarine parts which have unrequired inventory have little potential for future use because

the items have no users, past demands, or forecast demands. These parts meet some, but not all four of the DOD's criteria for being considered for elimination from the inventory. We believe the requirement to meet all four criteria is too restrictive.

We also estimate that another 31,000 ship and submarine items for which the Navy has unrequired stocks meet current Defense Inactive Item Program criteria for possible elimination from the inventory, but few items are being considered. The Navy's last inactive item review eliminated about 1,500 items and a special project eliminated another 3,200 items.

We estimate that the Navy is spending $24 million annually to store and manage these 140,000 items which may be of no use.

REASONS FOR UNREQUIRED STOCK

We identified the causes of unrequired inventory for 45 of 100 randomly chosen items. We could not determine why an additional 54 sample items had unrequired inventory (one item was determined not to have unrequired inventory). Either records were not available or item managers were not sufficiently familiar with the 54 items to explain why the items had unrequired inventory.

Based on its sample, we estimate that about $900 million of the unrequired inventory resulted from requirements that changed. Reasons for the changes included planned program requirements and demands that changed or did not materialize. We also estimate that about $1.7 billion of unrequired inventory resulted from the Navy's fleet modernization efforts, which included replacing and phasing out equipment and deactivating ships.

We estimate that the Navy would not be able to explain why about $1.2 billion worth of the inventory was unrequired. The Navy does

not require item managers to keep records justifying purchase decisions beyond when the material is received. In addition, many item managers have been responsible for their items for only a short period of time. As a result, information is not available to identify the basis for past purchases or to identify events causing items to have unrequired inventory.

We believe that the lack of information can hinder item managers in that they are not aware of why items were purchased, why the items have unrequired inventory, or even why the items are being retained. Having such information could help item managers to recognize causal factors and thus minimize the purchase of items that could become unneeded, and would help them to decide which items should be retained.

MINIMIZING UNREQUIRED INVENTORY

We found that the Navy does not systematically notify inventory control points that items are being replaced or phased out. Even when notified, inventory records often contained no information to alert the responsible item managers that items are being replaced or phased out. We believe that procedures to disseminate and record data on items being phased out are necessary to keep unrequired inventory to a minimum.

The purchase of one sample item was finalized after the inventory control point was notified that the item was obsolete. We believe that terminating that contract effort before the contract was finalized would have avoided acquiring unneeded inventory.

INACTIVE ITEMS

In 1988, the Navy only eliminated about 1,500 items under the

Defense Inactive Item Program and another 3,200 under a special project.

Our sample included 57 items that did not meet all four DOD criteria for being considered inactive for elimination, but had one or more characteristics that indicate little potential for future use. For example, 15 items had no users, 45 items had no demands in the past 2 years, and 33 items had no forecast demands. We estimate that of the 183,000-item population, about 109,000 items, valued at $2.3 billion could be evaluated for elimination if items did not have to meet all four criteria to be considered inactive.

We found that 11 sample items met all four DOD criteria for being classified inactive and should be considered for elimination from the inventory. We estimate that an additional 31,000 items should be considered under existing criteria.

Based on DOD cost estimates, we estimate that it costs the Navy $24 million to store and manage items that meet criteria to be considered for elimination and that could be considered if fewer criteria were required.

ATTACHMENT III

DLA SUPPLY MANAGEMENT ISSUES

Our work at DLA addressed issues which can contribute to inventory growth in excess of requirements. We have issued our report on excess materiel on order, and our work is almost complete on the Diminishing Manufacturing Sources Program, customer returns, procurement leadtimes, and items for which status is unknown.

DLA EXCESS ON ORDER

To avoid buying unneeded supplies, DLA's computer system identifies items for possible termination that are on order but, based on current information, may no longer be needed. When the computer identifies items that are potentially excess, item managers are to review the computer data and, if appropriate, direct the contracting officer to terminate the contract if no costs are involved. If termination costs are involved, the contracting officer is to obtain the costs from the contractor. Then item managers are to evaluate the costs and determine if terminating the contract or reducing the order is in the government's best interest.

Item Managers Make Few Termination Recommendations

Based on our random sample at three supply centers, we estimate that from a universe of $683.1 million, the value of excess materiel on order for contracts over $5,000 was between $204 million and $449.1 million. For these contracts, item managers requested terminations valued at only $49.9 million. We found that these supply centers purposely avoided making some additional terminations. For example, if the Construction Supply Center had adopted a $5,000-threshold similar to other supply centers, the

Center would have considered an additional 879 contracts valued at $8.5 million for termination.

We also found instances when item managers questioned requirements but recomputed requirements using incorrect data. In these cases, supervisors either did not review or change the item manager's decision. These cases resulted in a 1-year to 33-year oversupply of such items as solenoid valves, hospital gowns, women's dress shirts, and utility trousers. Item managers also simply increased requirements to stop the computer from reporting items as being excess and on order. For example, the item manager increased requirements for fire retardant shirts to avoid computer identification of the item as excess. Consequently, the supply center purchased a 7-year supply of shirts valued at $8.7 million.

Contracts Not Terminated When Some Costs are Involved

During the last half of fiscal year 1988, the six supply centers reported terminated contracts valued at $65.8 million, even though item managers requested that $253 million in excess materiel be terminated. The low termination rate is attributed in large part to the practice of not terminating contracts when costs are involved. Contracting officers are not providing information on estimated termination cost to item managers. For example, in May 1988, the aircraft yoke subassembly item manager recommended to the contracting officer that 586 subassemblies valued at $251,980 be terminated. The contracting officer took no action on this recommendation because (1) the contract administrator was negotiating a delivery extension and (2) the contractor would not accept a no-cost termination. However, another option existed. The contract may have been terminated without cost to the U.S. government because the contractor could not meet the delivery terms of the contract. The unneeded subassemblies represented almost a 10-year supply.

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Neither DOD nor DLA has developed adequate guidance for item managers to follow when evaluating the economics of contract terminations. Item managers need to consider such factors as amount of termination cost, the degree unneeded items exceed actual requirements, the cost of the items, and the storage cost for accepting unneeded items. Until item managers consider these factors in doing cost benefit analysis, supply centers will continue to purchase items not in the government's best interest.

DIMINISHING MANUFACTURING SOURCES AND MATERIEL SHORTAGES PROGRAM

DOD's program objectives are to (1) minimize the impact of diminishing sources parts, (2) improve operational readiness by identifying and implementing the most effective solutions to diminishing sources problems, (3) ensure such parts are not designed into new systems, and (4) develop procedures to ensure an integrated approach to improve responsiveness to diminishing sources situations. Each DOD component was to set up focal points to implement the DOD policy.

DOD's solutions to minimize the impact of parts non-availability include encouraging the existing source to continue production, finding another source, substituting a part, redesigning or replacing the item on which the part is used, and making life-of-type buys (one-time buys for the total future requirement of parts only after all cost-effective and prudent alternatives have been exhausted).

When a life-of-type buy is the only alternative available to a diminishing supply situation, DLA requests the services to provide future requirements for the part. The services do not always

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provide adequate information. Consequently, DLA buys based on past demands which does not ensure proper quantities are bought.

DLA used various ways to calculate life-of-type buy quantities. Some of these methods overstated the needs and resulted in too much stock being bought. From a random sample, we found that for 122 buys the Defense Electronics Supply Center made, it had an average of about a 58-year supply on hand. Much of this stock is potentially excess and may never be used. Attachment IV shows years of stock on hand that is managed by the center.

Procurement Leadtimes

Overstated leadtimes can cause increased investment for larger inventories, greater chances of buying excess materiel, and increased termination costs if requirements change. Understated leadtimes can cause shortages of needed supplies, which could affect the operational readiness of weapon systems or their components.

As of September 30, 1989, the average procurement leadtimes for DLA supply centers ranged from 4 to 17 months. This required DLA to maintain on-hand and on-order inventory levels valued at about $5.4 billion.

Our preliminary results indicate that DLA has not implemented controls adequate to manage and minimize procurement leadtimes as directed by the DOD. Our sample items at the two supply centers had leadtimes that were either overstated or understated, thus increasing the risk of buying too much or too little stock.

Even though DLA has taken measures to reduce the time it takes to award contracts, it has not tried to reduce production and delivery times by obtaining the best delivery dates from contractors.

Production and delivery times account for 60 percent of total procurement leadtime.

Materiel Returns

Customer returns to DLA, excluding fuel and subsistence items, totaled $3.1 billion for fiscal years 1981 through 1988 and averaged about 8.5 percent of its sales. For the same period, DLA's total inventory increased $5.7 billion, from $3.1 billion to $8.8 billion, or about 184 percent. Stocks excess to its current operations and war reserve needs more than tripled from $1 billion to $3.5 billion. However, there is no way to determine how much materiel returns contributed to DLA's inventory growth and excess materiel because of the high number of transactions involved and the inability of the inventory and accounting systems to provide such data.

DLA and the services have implemented and have underway numerous initiatives to avoid excess and reduce returns. The initiatives are designed to reduce not only the returns but also excess materiel. In addition, the services have programs to improve their internal redistribution procedures for excess materiel.

We do not plan to make recommendations on materiel returns, because (1) the services' corrective actions are too new to evaluate their impact on returns to DLA and (2) the September 1989 DOD Inspector General's report contains recommendations, which if implemented, would require a DOD returns program managed by the wholesale inventory managers, which includes DLA.

Stock of Unknown Status

Stocks that cannot be issued because their condition is unknown do not contribute to military capability but still result in holding

costs. Also, DLA and the military services may purchase new items when items on hand could have filled their needs. Consequently, DOD has set deadlines for resolving the status of such stock. Resolution consists of determining the condition of the items and deciding on their disposition, such as placing them in inventories of usable items or disposing of them.

Our preliminary tests indicate that many items remain in an unknown status long past mandated deadlines. Inventory policies and procedures may not be fully adequate to ensure timely resolution of these suspensions, nor to ensure the use of such items once their status has been resolved. For example, defense policies and their implementation instructions do not address organizational responsibilities, criteria for assigning status codes, or priority for reduction of such stock. We did not find procedures to ensure following up on stock that has been suspended for a long time. Instead, each activity is directed to develop its own guidance for such matters. At the activities we visited, preliminary indications were that local guidance was sometimes weak, and in some cases none had been prepared.

We will report our final results to you when our work is complete.

ATTACHMENT IV

ATTACHMENT IV

YEARS OF DIMINISHING MANUFACTURING SOURCES
STOCK MANAGED BY THE DEFENSE ELECTRONICS SUPPLY CENTER
AS OF JUNE 25, 1988

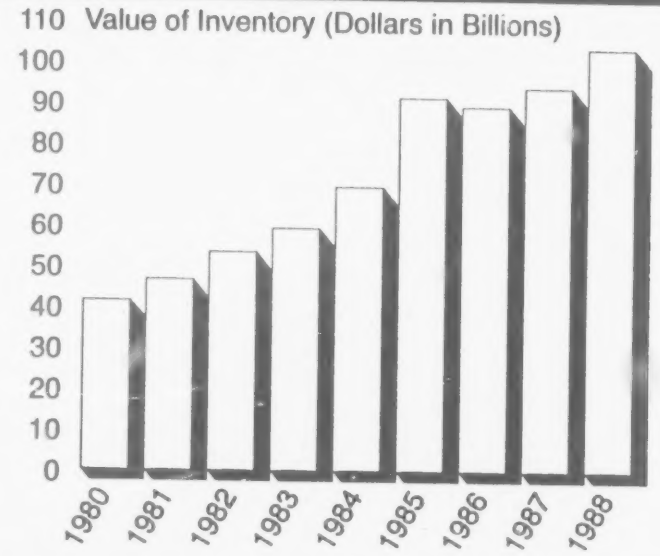
Years of stock on hand	Number of parts	Percent of total	Total assets	Percent of total
0	662	9.51	$ 107,692.94	0.04
.1 TO 1.0	373	5.36	2,061,399.18	0.68
1.1 TO 2.0	310	4.45	2,047,695.48	0.68
2.1 TO 3.0	330	4.74	2,728,920.37	0.90
3.1 TO 4.0	243	3.49	2,336,119.60	0.77
4.1 TO 5.0	244	3.50	4,590,229.03	1.52
5.1 TO 7.5	512	7.35	24,369,325.25	8.05
7.6 TO 10.0	468	6.72	31,558,508.57	10.42
10.1 TO 25.0	1,525	21.90	102,229,876.30	33.76
25.1 TO 50.0	913	13.11	55,753,763.84	18.41
50.1 TO 100.0	625	8.97	34,826,032.09	11.50
100.1 TO 200.0	374	5.37	15,275,239.34	5.04
200.1 TO 300.0	139	2.00	5,386,252.34	1.78
300.1 TO 700.0	157	2.25	8,662,441.22	2.86
700.1 TO 900.0	27	0.39	2,979,450.14	0.98
900.1 TO 1000	10	0.14	411,475.43	0.14
1000.1 TO 1500	24	0.34	1,674,819.25	0.55
1500.1 TO 2000	11	0.16	1,499,132.54	0.50
2000.1 TO 3000	12	0.17	1,479,411.26	0.49
3000.1 TO 4000	2	0.03	136,386.05	0.05
4000.1 TO 5000	0	0.00	0	0.00
5000.1 TO 7500	2	0.03	338,635.87	0.11
OVER 7500	1[a]	0.01	2,381,943.28	0.79
TOTAL	6,964	100.00	$302,834,749.37	100.00

Source: DMSMS stock status report dated June 25, 1988.

[a]This part had about a 22-year supply on hand. The Center's report was erroneous because the computer data file did not reflect actual demand data for the part.

CHART I

GAO Growth in DOD Inventories of Secondary Items



Note: Secondary items include spare parts, repair parts, and commodity items.

Source: DOD Supply System Inventory Report.

CHART I

GAO DOD Secondary Inventories by Category (1980 and 1988)

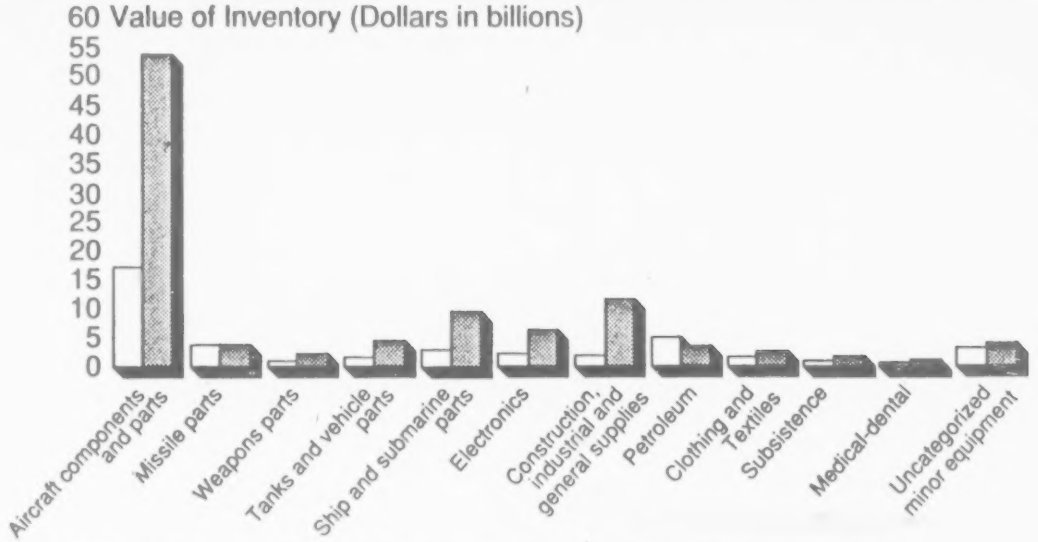
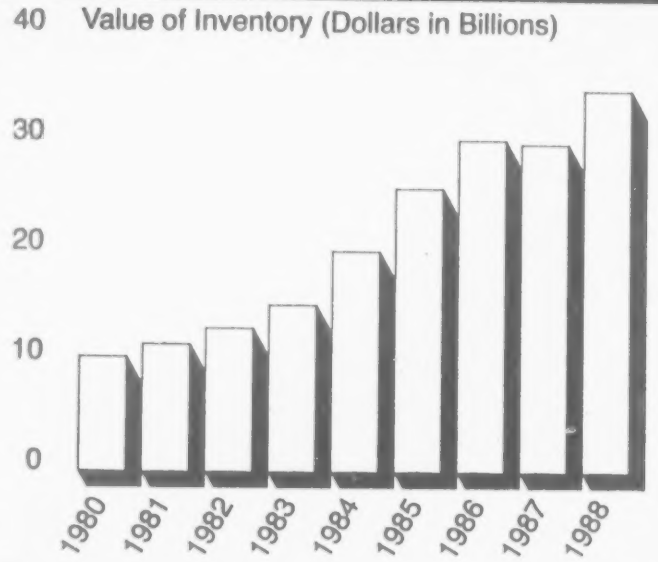


CHART II

GAO Growth in DOD Secondary Inventories That Exceed Stockage Objectives



Note: Secondary items include spare parts, repair parts, and commodity items.

Source: DOD Supply System Inventory Report.

CHART III

CHART III

CHART IV

GAO DOD Secondary Inventory—Required and Unrequired Stocks (1988)

Secondary items include: spare parts, repair parts and commodity items.
Source: DOD Supply System Inventory Report

CHART IV

STATEMENT BY

HONORABLE DONALD J. ATWOOD
DEPUTY SECRETARY OF DEFENSE

BEFORE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

IMPROVING FINANCIAL AND MATERIEL MANAGEMENT THE DEPARTMENT OF DEFENSE

MARCH 6, 1990

Mr. Chairman and members of the committee,

I am pleased to be before the Committee today to discuss the strength of our financial and material management systems.

These matters have generated quite a bit of comment lately which are of concern to me. A recent GAO report on Air Force financial management operations suggests that we had insufficient control over property and inventory assets, unsupported adjustments and inaccurate reporting in our accounting systems. The Senate Budget Committee's majority staff report questioned the need for over $30 billion in inventory items and other GAO reports have addressed needed improvements in materiel management.

These issues, among many others, led Secretary Cheney and me in our efforts to focus the Defense Management Report (DMR) toward a fundamental reform of the acquisition and management process. We are doing this by continuously challenging the ways our organization does business. In looking at requirements across DoD, we feel there are redundant, Service unique systems and operations lacking overall integration. We have generated new and creative initiatives to change our business operations. Our changes involve interrelated efforts primarily directed to support activities.

Under the DMR umbrella, I have also launched a Corporate Information Management initiative to integrate the data flow within common functional areas.

- DMR and Corporate Information Management initiatives are changing management techniques and structures, as well as information system integration perspectives and requirements. These initiatives will change the supply, inventory and accounting process and create design requirements for new DoD-wide integrated systems with common approaches in seven initial functional areas. Representatives from each Military Department and the defense agencies are working in functional groups to achieve these objectives. The initiative starting dates are in parentheses.

- Distribution Centers (12/89)
- Civilian Payroll (12/89)
- Financial Operations (3/90)
- Materiel Management (4/90)
- Contract Payment (4/90)
- Civilian Personnel (4/90)
- Medical (4/90)

These efforts are intended to eliminate separate Service systems and provide integrated systems that can relate to each other, as well as across all of DoD. The systems will provide management at every level with useful and timely information. Contract data will integrate with fund controls, contractor material requisitions, delivered items and warehouse stocks, as well as payment and accounting requirements.

- Consolidation Studies are underway to eliminate unnecessary organizational layers of personnel and non-value added functions. Reports on seven initial studies will be delivered to me by May 1, 1990. These studies will review consolidation proposals and provide detailed implementation plans for:

- Supply Depots
- Inventory Control Points
- Aeronautical Maintenance Depots
- Accounting Operations and Finance Centers
- Other Maintenance Depots
- R&D Laboratories
- ADP Operations and Design Centers

As is apparent from these initiatives, our actions are designed to solve the very concerns raised in the various reports. About half of our initiatives deal with the topics at this hearing. In addition, recent world events have reinforced and accelerated the need for these actions and initiatives. This is only the beginning of the cultural change we seek to achieve in the Department.

My subsequent comments on the particular matters at hand should be considered within the overall management plan, perspective and context which I just outlined. With that view point in mind, I would like to update you on our efforts to improve the material management process. An efficient and effective supply and inventory management system is a primary objective of the DoD. At the same time, we recognize that meaningful solutions will require the commitment of both the Administration and Congress.

MATERIEL MANAGEMENT

The DoD inventory management program is the largest in the world. It includes an inventory valued at approximately $100 billion, composed of nearly 5 million different items. The

purpose of the inventory is to provide replacement parts and other consumable items to maintain the readiness and staying power of our ships, aircraft, tanks, and other complex weapon systems used by our military forces. Quality weapon system support is one of the most important factors in the defense readiness equation; and today, as our Armed Forces demonstrated in Panama, our readiness is at a record high. We all agree that we need an inventory of spare parts to sustain our forces. What is at question is whether the Department is investing taxpayer dollars wisely in the selection and quantity of procured items and whether we are managing these inventories effectively and efficiently using integrated systems that provide item visibility and financial control.

The sheer size of the Department's inventories reflects the defense strategy of the 1980s which called for a major modernization effort and the development of a number of new weapons systems to transition rapidly from a "hollow" force to a military posture capable of executing the national security strategy. The $100 billion in spares and material supports nearly $400 billion invested in military capital equipment.

I would now like to take a few minutes to highlight what we have accomplished and where we plan to concentrate our efforts in the future.

DEFENSE MANAGEMENT REPORT (DMR) AND CORPORATE INFORMATION MANAGEMENT (CIM)

The DoD is engaged in a sustained, long-term effort to streamline its management, with a special emphasis on the Defense logistics infrastructure and supporting functional systems. DoD's approach to achieving efficiencies includes improving the quality of management using integrated functional systems support, while reducing overall costs.

REDUCING INVENTORY BUYS AND REDUCING ON-HAND INVENTORY

As a result of dramatic world events and anticipated reductions in forces and weapon systems, the Department is undertaking two major actions: (1) to reduce what we buy for the inventory each year, which has a dollar impact on the budget, and (2) to dispose of inventory on-hand which is no longer needed to support weapon systems or previous threat scenarios.

REDUCING WHAT WE BUY

Within the Department's comprehensive plan, initiatives underway to reduce what we buy annually include:

Procurement Lead Time Reduction

Procurement lead times determine the amount of stock we must carry --- the longer the lead time, the more inventory we must stock to ensure against extended delivery schedules and interrupted sources of supply. Recognizing the potential for

significant savings if procurement lead times are reduced, the Department has targeted this area for major improvements. The various DMR and CIM initiatives will provide integrated item and cost information to the managers responsible for buying supplies. In December 1986 and April 1989, we issued guidance to the Services to reduce procurement lead times. In May 1989, the Department conducted a Procurement Lead Time Reduction Conference attended by senior inventory management and procurement personnel from all the Components to seek additional ideas and approaches for reducing procurement lead times. As a follow-on, a joint DoD/Industry task force is currently identifying specific implementation actions to reduce lead time. Other initiatives include better automation tools for the procurement process, greater use of multiyear contracting, and regulatory relief to remove impediments to timely procurements.

Revised Order Quantity Policy

Several years ago, in an attempt to obtain better price breaks on larger buys of spare parts, the Services and the Defense Logistics Agency began buying one year's worth of some items (previously smaller quantities were purchased on a more frequent basis using economic order quantity computations). In some cases, the annual buys were more economical; however, for many items the annual buys contributed to greater on-hand inventories and related holding costs with little improvement in prices. A number of audits found that an "annual" buy program increases the risk of buying items that will go into the

inactive inventory. The Department issued guidance in June 1989 which ended the practice of annual buys and reestablished the procedures of using economic order quantity computations. However, to ensure that the Department did not swing too far in the other direction, guidance now requires the DoD Components to solicit routinely quantity price discounts. The DoD-wide CIM systems I previously mentioned should assist in determining the economical order points based on requisitioned items, holding and acquisition costs.

Use of Commercial Items and Distribution Systems

DoD initiatives to use commercial items and distribution systems include: (1) authorizing local purchase of non-weapon related supplies up to $5,000 per line item when this represents the best value; (2) "just-in-time" arrangements to deliver materiel directly from contractors to users; and (3) a series of regulatory and policy revisions to increase DoD's use of the GSA Federal Supply Schedule program. The net result has been a 36 percent increase over the last year in the use of commercial items and distribution systems (from $1.4 billion in FY 1988 to $1.9 billion in FY 1989). Integrated CIM systems should provide even more relevant management data than now available and allow even greater item and buying visibility.

Item Identification and Reduction

With almost five million items in the DoD inventory, the task of identifying and minimizing duplicate items is a

significant challenge. The Federal Catalog System was originated in 1952 with this objective in mind. To the extent possible, automation is being used to scrutinize candidate additions to the inventory. The Department is presently in source selection for a new system called "Cataloging Tools on Line" (CTOL), an automated work station approach to cataloging new items as they are received from the provisioning process. CTOL will permit a more comprehensive review for item identification, which should prevent duplications from entering the inventory system. We expect this new capability to increase productivity by 30 percent.

To improve the solicitation process even further, the Department is acquiring a "Federal Logistics Data On Compact Disc" (FEDLOG) capability. FEDLOG places the entire federal catalog, plus selected Service data bases, on Compact Disc Read Only Memory (CD-ROM). This medium will allow users to research logistics data records quickly for the correct item to meet mission needs. The retrieval software also simplifies the identification of potential duplicate items that may be in the existing file. Adding this new capability will reduce the number of activities performing the cataloging function. Consolidation should inject greater discipline in the item identification process, resulting in better use of the CTOL and a probable reduction in overhead and administrative support costs. Our ongoing CIM materiel, supply and inventory system initiatives should eclipse these individual systems and provide far more comprehensive data for managers at all levels. The

consolidation studies should add an even greater dimension to the efficiency and effectiveness within these functions and across DoD.

Improved Initial Provisioning

"Provisioning" is the supply process that introduces the initial order of spares and repair parts to support a newly-fielded weapon system. This process predicts the type and number of spare parts needed before actual demand experience is available. It is an engineering estimate of what will be needed. In March 1989, we directed a comprehensive review of the provisioning process to determine if provisioning was contributing to inventory growth, particularly since we had just emerged from an extended period of new weapon system acquisitions. Even though the task group found the provisioning process to be a small contributor to inventory growth, the review confirmed the need to improve the process to generate additional savings.

Responsive Reductions to Requirements

The Department is assessing whether extraordinary inventory management actions may be necessary to respond to anticipated force structure reductions, as they relate to reparable and consumable item management. Reparable items are the most expensive spares in our inventory, and, as the name implies, are repaired and reused after they fail. (An example of a reparable item would be a fuel control unit on an aircraft engine.)

Requirements for reparable items are based on future training requirements (i.e., number of flying hours) and estimates of wartime utilization for the end items (i.e., aircraft) supported. Adjustments for force structure changes or reductions in operations are currently done through an automated process, which imply that the current system should be responsive to dynamic changes; however, we will monitor this activity closely.

Requirements for consumable items, which are generally piece parts for repairing end items and other items consumed in use, are based primarily on past demand. Adjustments to force structure changes for consumable items will be more difficult; however, the Department is currently developing the means to refine requirements linked to projected end item availability. We want to recognize, with the current complication of long lead times, that a sudden drop in demands could force on-order items into the inactive inventory; but management will be proactive in monitoring this activity. CIM initiatives should obviate the existing system and should greatly enhance our monitoring capability by detecting and projecting demands even more accurately and timely.

On-Order Contract Terminations

After the requirement is identified, and the contract award has been made, changes in mission or demand occasionally make all or a part of an order for material move into the inactive category, items not consumed within two years. In order to

preclude these kinds of orders from entering the inventory, DoD issued guidance on contract terminations to the field in December 1989. This guidance reemphasized the need to review and verify requirements prior to contract award and provided criteria to determine whether post-award termination of contracts is in the best interest of the Government.

REDUCING ON-HAND INVENTORY

What has already been procured, delivered, and stocked in our warehouses is money already spent, which means that reductions in the on-hand inventory do not generate a reduction in annual "procurement" dollars. Disposal of inventory does, however, reduce the cost of holding the material and reduce our requirements for warehouse space, both of which are sufficient reasons for reducing the on-hand inventory. (Reduced space requirements do not address the need to upgrade or replace older warehouses.) The CIM initiative on warehousing (distribution centers) in conjunction with the other related initiatives will upgrade DoD-wide visibility over holding and space costs and requirements. Other initiatives to reduce on-hand inventory include:

Revision of the DoD Retention and Disposal Policy

During the late 1970s, the Department was under heavy criticism by the GAO for disposing of material that was still usable on weapon systems in the inventory, regardless of the number of years of supply on hand. Being responsive, the Department issued a new policy to retain all material, even

though we understood it would migrate into an inactive inventory. Over time, that policy change accumulated a larger-than-expected inactive inventory. Now the Department is under an opposite pressure to reduce the overall size of the inventory by disposing of the material.

Material has also been retained as the result of the military buildup of the 1980s. Logically, retaining material that would eventually be used by an expanding and modernized force made good economic sense. Now, with a probable reduction in force structure and operating requirements, we are reevaluating our retention policy.

In our support of efforts to reduce inventories, we must, however, guard against sudden, abrupt changes in policy which may (1) reduce readiness or (2) overwhelm our ability to dispose of unneeded material properly. Our plans are to permit an orderly, systematic implementation of new retention rules. We will concentrate first on reducing stocks of unserviceable and obsolete items, and will then evaluate stocks held for economic or contingency reasons. We will also look for opportunities to transfer material to meet foreign military sales needs, support humanitarian assistance programs, or satisfy low-intensity conflict requirements of other nations.

We are particularly concerned about the ability of the DoD, Federal, and State disposal programs to process large amounts of material in a short period of time. We are already pursuing alternative procedures to accelerate disposals in an orderly fashion such as sales in place, reduced screening periods, and

the use of storage space freed up by base closures as temporary materiel staging areas.

Our efforts to dispose of material is already showing results. Disposal of unserviceable and obsolete items have increased 30 percent over the last year (from $6.5 billion in FY 1988 to $8.4 billion in FY 1989).

A recent Senate Budget Committee report alleged that $30 billion of our spare parts are unneeded. This is simply not the case. Instead, $21 billion of that $30 billion in inventories are spares and supplies needed to support existing weapon systems or personnel beyond the end of the next budget year. These inventories, which have been referred to as "inapplicable" are more appropriately termed "inactive." One reason for retaining inactive spares is to continue support for older weapon systems, long out of production but still in use by our forces, allies, and friendly nations. Another reason is the high variability of demand for spare parts supporting today's complex weapons. Forecasting spares requirements two to three years in advance of delivery is not an exact science. Long procurement lead time between initial order and final delivery is a major contributing factor. That complication is one of the major targets of the Department's comprehensive integrated program to improve current buying policies and processes. We fully expect the various CIM initiatives for supply and inventory will provide a fully integrated creative approach to the matching of program needs to acquisition buys.

Nine percent ($9 billion) of our supply inventory is currently classified as "potential excess," materiel the Department does not expect to use in the future. This is less than what GAO attributed ($10 billion) to the Air Force in their report on financial management. Use of the term "excess" is also inappropriate, especially when applied to the larger inactive inventory ($30 billion). A more accurate term is "unserviceable and obsolete." Approximately two-thirds of the dollar value of what is appropriately called "unserviceable and obsolete" is unserviceable items that were needed, used, and were, in fact, used to the point that they are now in need of further repair or are uneconomical to repair. The other one-third is made up of obsolete items, largely a direct result of a decade of modernization.

Warehouse Construction

Recent congressional reports have alleged that DoD has initiated millions of dollars of new warehouse construction for the purpose of holding our purchases of "unneeded" inventory. This allegation is incorrect and purports to cast a dark shadow on the congressional committees who have worked in partnership with the Department to achieve a balanced, well planned, military construction program. The facts are that current DoD expenditures on warehouse construction are intended to improve productivity through modernization, replace damaged or outdated structures, or comply with new environmental standards for storage of hazardous material. During the past five years, the

total net square footage available for materiel storage has actually declined by 4.5 percent. This emphasis has been on "replacement" facilities, not expansion.

Moreover, warehouse modernization improves inventory accuracy by improving warehouse location and retrieval capabilities. Our ability to find materiel in the proper warehouse location is up to 97.7 percent, an enviable record of performance for any large business. Even so, the CIM warehouse initiative, which will provide an integrated DoD-wide perspective, should improve that identification capability.

OTHER INITIATIVES TO REDUCE THE COST OF DOING BUSINESS

Defense Management Report

A portion of the Defense Management Report addresses initiatives to improve the overall management of the supply system. Specifically, our efforts to reduce supply systems costs have identified areas in which an initial 3 percent reduction in the cost of managing materiel is anticipated. Proposed changes in the process to generate the savings include multiyear contracting, use of the Stock Fund to finance the acquisition or update of drawings and technical data for "best value" reprocurement actions, and use of the stock fund to procure forgings and castings to reduce substantially procurement lead times.

Modernization of Inventory Management Information Systems

The Modernization of the Defense Logistics Standard Systems (MODELS) consists of a redesign of all of the DoD's logistics business transactions using commercial electronic data interchange (EDI) technology and developing a structure of electronic "gateways" through which all electronic logistics traffic will pass. This technology improvement will establish a new "flexible standard" for transmitting logistics business transactions. The initial version of MODELS is scheduled for implementation in late 1991. The initial prototype tests at six Military Service and Defense Agency sites have been successful, and expansion from the initial test mode to the first pilot operational net is proceeding on schedule. Our CIM initiatives are expected to capitalize and extend such technology on an even broader basis throughout the entire DoD community.

Spare Parts Pricing

The Department has made substantial progress since 1984 to identify and correct root causes of potential overpricing. Over 500 initiatives have been institutionalized by the Services and DLA through programs such as the Navy "Buy Our Spares Smart" (BOSS) program.

Voluntary refunds, where the Government has no direct contractual right to obtain compensation for a perceived overcharge, have been effective. The private sector is aware that the Government will pursue reconciliation for overpricing, even after contract award and payment, as well as other actions when fraud or defective pricing are involved. The numbers of

refunds are down, which implies that our message to supply sources has been effective.

Stock Funding of Depot Level Reparables

Based on a successful Navy test, the Department is expanding, under a DMR initiative, its program to finance the procurement and repair of reparable items with Stock Funds to the Army and the Air Force. Under the stock fund concept, users must reimburse the Stock Fund with operating funds rather than receiving them "free" as they do when reparables are financed through central appropriations. By establishing a buyer-seller relationship, users are better motivated to conserve items and repair only what they need. The Navy's implementation of stock funding depot level reparables decreased procurement and maintenance costs while increasing stock availability and weapon system readiness. The Department believes that the Army and Air Force will realize similar benefits from this DMR change which is proposed in the fiscal year 1991 budget.

Non-Conforming Parts

Recent audits have centered on parts in the inventory that do not conform to the specifications of the original contract. An action plan for correcting root causes of non-conformance was developed by the Services and DLA. This plan contains 26 objectives addressing the pre-contract, contract award, and contract administration phases of procurement. DLA has already

implemented major elements of the plan, well ahead of projected milestone dates.

Diminishing Manufacturing Sources

DoD established a Diminishing Manufacturing Sources task force to develop an implementation plan to reduce the impact of lost sources of supply, and to find alternate sources to overcome the short-notice problem. At the same time, we have also been working with industry's Multi-Association Working Group to address the problems from their point of view, as well. The plan includes such actions as improving life-of-type buy calculations, motivating industry to provide advance notification of intentions to discontinue production, and encouraging "after-market manufacturers" to buy existing manufacturing technology and production lines to ensure continued support to DoD.

Physical Inventory Management

The DoD physical inventory control program is composed of five major elements: (1) location audits, (2) physical inventories, (3) research, (4) quality control, and (5) performance measurement. The overall thrust of the program is to con ntrate limited resources to fix problems with the greatest dollar impact on DoD operations. The CIM initiatives cutting across materiel management operations should enhance our abilities to deal more effectively and efficiently with these major elements.

Maintaining accurate inventory records is a continuous and significant workload in DoD. Annually the Department conducts approximately 9 million warehouse location audits, 18 million record reconciliations, and physically inventories 3 million items. While the effort put forth in this area is formidable, the payoff makes it well worth the investment. Over 99 percent of the 39 million demands for materiel placed on the warehouses during FY 1989 were completely satisfied, again an enviable record for any large business.

While errors do occur, such as the 80,000 jungle camouflage helmet covers contained in the staff report to the Senate Budget Committee, these anomalies are genuinely the exception rather than the rule. During the past several years, the GAO conducted seven independent sample inventories, with resultant unit and dollar value accuracy rates of approximately 95 percent.

While the Department's physical inventory control program has been able to cope successfully with substantially larger inventories and maintain or improve accuracy levels, the Department is continually striving for even higher levels of inventory accuracy and better security. To do so, the Department institutionalized a continuous improvement process through the annual Physical Inventory Control Program Plan (PICPP). The plan sets priorities and establishes guidelines for targeted process improvements over the next five years.

Applications of technologies such as bar coding, microcircuits, and radio frequency transmission are reducing human errors in data collection, recording, and transmission.

The increased use of statistical techniques for process quality control are pinpointing more precisely where management attention is needed. The modernizing of ADP systems is improving the quality and timeliness of information needed for disciplined management and control. Ultimately, moving to a single asset balance record system tied into our CIM financial operations accounting system should eliminate the need to reconcile multiple records and ameliorate a major source of inventory variances.

The automation of depot operations and use of automated storage and retrieval systems is substantially reducing manpower-intensive tasks. Sophisticated control systems are also reducing the opportunity for pilferage and theft. Improved automated inventory techniques will flag for investigation any unusual movement or loss of items. In addition, new warehouse facilities are inherently more secure than the aging facilities they replace, since internal security and resistance to external forced entry are part of the basic facility design. All of these physical inventory management initiatives are expected to be institutionalized by CIM functional requirements and integrated with financial operations.

Within the past six months the Department has submitted two reports to the Congress, "Inventory Security & Control Procedures Review and Modernization Plan," dated September 1989, and "Security & Control of Supplies for Fiscal Year 1989", dated January 1990. The two reports document the Department's comprehensive assessment of our system, its accomplishments to

date, and our ongoing plans and programs for further improvement. A copy of each report can be made available for the record.

RECOGNITION OF IMPROVEMENTS ALREADY UNDERWAY

As the committee indicated in its recent letter to the Secretary of Defense, the current level of defense requirements is indeed, uncertain. Responses to these dynamic world changes are particularly difficult, given the inexact science of forecasting materiel demand. Despite the challenges of long lead times for budget development and approval, and lengthy procurement lead times, we have already made significant adjustments to our FY 1991 budget requirements for spares, currently under congressional review, by reducing materiel acquisition budget requirements by $1.3 billion. These reductions were made possible as the result of actual or anticipated decreases in materiel safety levels, procurement lead time, non-demand based stockage, and materiel on-order.

ACTIONS FOR THE FUTURE

We have already made significant progress toward improving the Department's overall materiel management system and supply operations. Clearly, much remains to be done. We must evaluate each of our inventory management processes currently underway, to determine the appropriate composition of DoD inventories and to restructure budget requirements that will preserve military

capability while reducing the cost of doing business. Specifically, we intend to:

1. Develop the ability to respond quickly to changes in force structure, base closures, and organizational realignments.

2. Establish quantitative goals to measure progress toward reducing on-hand inventory, procurement lead times, repair cycle times, and order quantities.

3. Revise retention policies and procedures for the timely and orderly disposal of materiel.

4. Pursue vigorously all practical alternatives to increase the use of commercial items, just-in-time techniques, and electronic ordering.

We intend to take a hard look at the incentives that drive our people to do what they do. Through the CIM initiatives, we will encourage the use of better business practices by providing complete data visibility to our managers who are responsible for developing requirements and purchasing inventory. Our objective in this comprehensive integrated review is to make best use of the taxpayer's dollar.

SENATE BUDGET COMMITTEE REPORT

With regard to the three recommendations of the Senate Budget Committee report, I am pleased to tell you that the Department has already taken aggressive steps. For example, we responded to our Inspector General's report of last November, which cited the $1.8 billion worth of spares above new requirements but still on order, by issuing a new policy on

contract terminations, cited in the staff report. This change is reflected in the $1.3 billion reduction in the FY 1991 spares budget request.

IN SUMMARY

What has transpired in the past we can do little about. From this point forward...and since we are all in this together...we must work together earnestly to put in place a process for continuous improvement, to govern our inventory management practices--now and in the coming years--for a newly defined military force capability. However complex the task may be, we have charted a course using DMR and CIM initiatives to reduce the cost of stewardship, while preserving the fundamental military capability of the United States.

Now let me turn to another issue which I know greatly concerns this committee. This is the issue of GAO's audit of the Air Force's financial operations.

FINANCIAL MANAGEMENT

Recently, the GAO released its findings following an audit of the Air Force's financial management operations. The report concluded that there was a lack of control over property and inventory assets, unsupported adjustments, and inaccurate reporting in the Air Force's accounting systems.

As a former corporate official and long-time taxpayer, I recognize the need for large organizations like the Department

of Defense to have effective financial controls. I have been concerned about the basic accounting controls in DoD and agree that they are not up to the standard of those found in most large private-sector organizations. Because of these and similar concerns, President Bush and Secretary Cheney approved a series of initiatives clustered under the umbrella of the Defense Management Report. In this particular area, the Department already has initiatives underway to address many of the problems identified by the GAO.

Before I describe in more detail the actions being taken to resolve the problems, let me clear up one point that has been raised as a result of the GAO report. There is a perception in the media that the GAO report shows that the Air Force and the DoD have inaccurately reported the cost of DoD weapons systems to the Congress and to the public. It is clear that the records examined by GAO did not agree with the budgetary data provided to Congress. We feel confident that the budgetary data provided to Congress have been accurate because it is specifically collected from numerous financial sources for reporting in the Selected Acquisition Reports (SARs). The GAO acknowledges, the data reported on SARs are generally accurate. Moreover, GAO concluded that our funds control procedures assured that spending limits are not exceeded and this system is working effectively.

Nevertheless, this does not lessen the need to make all our accounting and financial documents whole and consistent throughout the Department. Let me describe how several of the

initiatives we have begun over the last couple of months are aimed at the problems identified in the GAO report.

DOUBLE ENTRY BOOKKEEPING

GAO criticized the absence of a double entry bookkeeping system. This tool is an absolute requirement in the private sector; however, it is not as widely employed in the public sector. In the Government, the establishment of a double-entry system requires the use of the governmentwide standard general ledger advocated by OMB and the Treasury Department. Our DoD-wide single integrated accounting system initiative, which just started as part of the DMR effort on Corporate Information Management, will incorporate this governmentwide standard general ledger and chart of accounts. The system will also comply with standard accrual requirements, record actual costs and provide cost visibility on a consistent basis throughout the Department. Furthermore, the system will preclude arbitrary or unsupported adjustments of the kind found by GAO in the Air Force. Adjustments would require written management authorization.

PROPERTY AND INVENTORY ACCOUNTING

The GAO also faults the Air Force because it did not properly account for or control physical assets. This has been another longstanding problem throughout the Department. Our DMR initiative on the development of standard systems will assure control of these assets from acquisition to consumption, or to

disposal, and will track the assets at every level. This will be done both through a standard financial accounting system and through an integrated materiel management system which will provide source data for the accounting system.

GOVERNMENT FURNISHED MATERIAL

The GAO also reported that Air Force property systems do not track military hardware, or government-owned material in the hands of contractors. This problem has also been long known and, prior to the DMR effort, no effective solution had been attempted. However, as part of DMR we have decided that complete accounting control will be established over all government material, or other government property, in the hands of contractors. This effort is a part of the single accounting initiative and will be integrated with the initiative for a DoD-wide materiel management system. The net result will be that DoD will account for and have control over material in the hands of government contractors at all times.

CONSOLIDATION

In addition, another group is studying the potential consolidation of accounting operations and finance centers throughout DoD. While GAO did not address this issue, we believe that streamlining and reducing the number of sites charged with keeping the books for DoD could provide better accounting discipline, as well as save money.

We already have teams working busily on these and other DMR and CIM initiatives as outlined in my preceding comments. Although final decisions are still in the future and must await the groups' proposals, I will give these consolidation initiatives a great deal of attention.

Mr. Chairman, I also know that the GAO plans to do similar audits in the Army and Navy to determine the extent of the problems in those accounting systems. Because we believe that the GAO will find many of the same conditions in these other Military Departments, I do not feel we can wait for the GAO reports to identify for us other issues which may need to be acted upon beyond those I have outlined above. Therefore, I have asked Sean O'Keefe, the DoD Comptroller, to review the state of DoD accounting systems and to report to me by May 1, 1990, his recommendations as to additional actions, or accelerated actions that may need to be taken to address both my concerns and the concerns of the Congress.

IN SUMMARY

I will end my testimony by assuring you Mr. Chairman and members of the committee that the initiatives I have just outlined for materiel management and financial management go to the heart of the problems found by GAO. DoD needs a standardized and consolidated accounting system under general ledger control where all property and inventory account values can be reconciled to physical counts of property, materials and

supplies and discrepancies can be investigated and documented. DoD financial statements must not only record our budgetary control over funds appropriated to us but also accurately and reliably record our stewardship over all assets and resources entrusted to our care and control. Finally, information required by Congress for weapon systems costs must tie into all our accounting records. The Department is committed to achieving this goal.

As you can see, we have designed specific initiatives in relation to identified problems which we've been working on since the President tasked us with the management review last year. The Secretary and I fully appreciate your constructive recommendations and will factor them into our implementation plans at every opportunity.

I believe that we have accomplished a great deal in the last year. But, DoD can do much more to improve the management of our nation's defenses. We could accomplish far more still with the assistance of Congress. By taking down statutory barriers to reducing obsolete inventories and eliminating the number of congressional amendments which require the Services to procure items in addition to or in excess of specific demand requirements, we could jointly take great steps to reducing the size of DoD's inventory.

Mr. Chairman this concludes my prepared statement. I will be pleased to answer any questions from you and other committee members.

STATEMENT BY

SUSAN J. CRAWFORD, INSPECTOR GENERAL

DEPARTMENT OF DEFENSE

BEFORE THE

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

SUPPLY MANAGEMENT

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM PLEASED TO APPEAR BEFORE YOU TODAY TO DISCUSS DEPARTMENT OF DEFENSE SUPPLY MANAGEMENT ISSUES. I AM ACCOMPANIED BY THE ASSISTANT INSPECTOR GENERAL FOR ANALYSIS AND FOLLOWUP, MR. ROBERT LIEBERMAN.

SUPPLY MANAGEMENT IS ONE OF THE MOST COMPLEX, CHALLENGING AREAS CONFRONTING DOD MANAGERS. CONSIDER THE FOLLOWING STATISTICS:

-- BETWEEN 2.5 AND 3.5 MILLION TRANSACTIONS FOR SECONDARY ITEMS (SPARE PARTS, SUPPLIES AND CLOTHING) ARE PROCESSED EVERY DAY.

-- THERE ARE OVER 900 MILLION SUPPLY TRANSACTIONS PER YEAR.

-- NEARLY 5 MILLION DIFFERENT ITEMS ARE CATALOGED, AND STOCKED ITEMS RANGE IN QUANTITY FROM ONE TO MANY THOUSANDS.

-- THERE ARE 9 MILLION NUMBERED STORAGE LOCATIONS IN THE WHOLESALE SYSTEM ALONE; AND

-- THE MONETARY VALUE OF THE SECONDARY ITEMS INVENTORY IS OVER $100 BILLION.

IMBALANCES IN SUPPLY SYSTEM OPERATIONS CAN HAVE TREMENDOUSLY COSTLY EFFECTS. THERE CAN BE NO MORE VIVID AN EXAMPLE OF SUPPLY SYSTEM FAILURE THAN THE SPECTACLE OF MULTI-MILLION DOLLAR WEAPON SYSTEMS UNABLE TO FUNCTION BECAUSE OF THE LACK OF SPARE PARTS OR OTHER SUPPLIES. AT THE SAME TIME, WHILE MAINTAINING HIGH OPERATIONAL READINESS WE SIMPLY MUST AVOID BUYING ITEMS THAT CLEARLY EXCEED REQUIREMENTS AND WASTE RESOURCES.

AUDIT COVERAGE

OVER THE PAST SEVERAL YEARS, THE OFFICE OF THE DOD INSPECTOR GENERAL AND THE THREE MILITARY DEPARTMENT AUDIT AGENCIES HAVE DEVOTED CONSIDERABLE EMPHASIS TO THE SUPPLY MANAGEMENT AREA. WE HAVE MAINTAINED EXTENSIVE COVERAGE OF VIRTUALLY EVERY FACET OF SUPPLY OPERATIONS, AT ALL ORGANIZATIONAL LEVELS. SINCE OCTOBER 1988, FOR EXAMPLE, THE DOD INSPECTOR GENERAL HAS PUBLISHED 35 AUDIT REPORTS ON THOSE MATTERS. THE ARMY AUDIT AGENCY HAS ISSUED 43 REPORTS, THE NAVAL AUDIT SERVICE 18, AND THE AIR FORCE AUDIT AGENCY 43. COLLECTIVELY, WE HAVE 74 AUDITS IN PROGRESS AND 24 OTHERS PLANNED FOR LATER IN FY 1990. THERE IS ALSO COVERAGE FROM THE DOD INSPECTION COMMUNITY AND THE GENERAL ACCOUNTING OFFICE.

THE DOD MANAGERS GENERALLY TRY TO BE RESPONSIVE TO THE DOD AND GAO AUDIT REPORTS ON SUPPLY MANAGEMENT. MANY CORRECTIVE ACTIONS HAVE BEEN TAKEN, OR AT LEAST BEGUN, IN RESPONSE TO THOSE REPORTS. NEARLY ALL OF THE SPECIFIC PROBLEMS ACKNOWLEDGED IN THE DOD ANNUAL ASSESSMENT OF INTERNAL CONTROL WEAKNESSES REGARDING SUPPLY OPERATIONS STEMMED FROM AGREED-UPON FINDINGS FROM DOD OR GAO AUDIT REPORTS.

OUR FINDINGS BASICALLY CORROBORATE THE SUPPLY MANAGEMENT PROBLEMS DISCUSSED IN YOUR 1988 REPORT AND IN THE SENATE BUDGET COMMITTEE REPORT ISSUED EARLIER THIS YEAR. THE GROWTH IN INAPPLICABLE INVENTORY, THE OVERCROWDING IN MANY DEPOTS AND THE HIGH INCIDENCE OF INVENTORY REPORTING ERRORS ARE INDICATIVE OF THE NEED FOR IMPROVEMENT IN EACH ASPECT OF SUPPLY OPERATIONS--REQUIREMENTS DETERMINATION, CATALOGING, PURCHASING, DISTRIBUTION, STORAGE, INVENTORY CONTROL AND DISPOSAL.

IT IS PARTICULARLY IMPORTANT THAT TOP LEVEL ATTENTION BE FOCUSED ON SUPPLY MANAGEMENT IMPROVEMENT NOW, AS WE MOVE INTO A PERIOD OF DEFENSE PROGRAM RESTRUCTURING AND DRAWDOWN. DECLINING DEMAND IS LIKELY TO CAUSE EVEN MORE GROWTH IN EXCESS INVENTORIES IN THE NEAR TERM. WE NEED AGGRESSIVE MANAGEMENT ACTION TO REVERSE THAT TREND AS SOON AS POSSIBLE.

TWO RECENT AUDIT REPORTS FROM THE OFFICE OF THE INSPECTOR GENERAL, DOD, ARE ESPECIALLY PERTINENT TO THE PROBLEM OF EXCESSIVE LONG SUPPLY.

DOD MATERIEL RETURNS PROGRAM

IN AN AUDIT REPORT ENTITLED "DOD MATERIEL RETURNS PROGRAM," ISSUED IN SEPTEMBER 1989, WE REPORTED THAT WHOLESALE SUPPLY MANAGERS FREQUENTLY AUTHORIZED RETAIL ACTIVITIES TO RETURN EXCESS MATERIEL TO WHOLESALE STORAGE DEPOTS INSTEAD OF DIRECTING SHIPMENT OF EXCESS MATERIEL TO MEET CUSTOMER REQUIREMENTS AT OTHER LOCATIONS. THE DOD COMPONENTS HAD DEVELOPED SERVICE-UNIQUE, LATERAL REDISTRIBUTION PROGRAMS THAT WERE NOT CONTROLLED AND DIRECTED BY THE WHOLESALE SUPPLY MANAGERS. THOSE REDISTRIBUTION PROGRAMS WERE RESTRICTED TO FILLING ONLY INTRA-SERVICE REQUIREMENTS AND HAD INCONSISTENT REIMBURSEMENT POLICIES. THE PROGRAMS HAD BEEN EFFECTIVE IN FILLING INTRA-SERVICE REQUIREMENTS; HOWEVER, NOT ALL EXCESS MATERIEL WAS BEING REPORTED, EXCESS MATERIEL WAS NOT MADE AVAILABLE TO FILL URGENT REQUIREMENTS OF OTHER USERS, AND DOD GUIDANCE ON ISSUE PRIORITY WAS NOT BEING FOLLOWED. THE LACK OF A DOD-WIDE LATERAL REDISTRIBUTION PROGRAM CAUSED ADDITIONAL COSTS IN SHIPPING EXCESS MATERIEL TO WHOLESALE DEPOTS, ADDITIONAL HANDLING AND ADMINISTRATIVE COSTS IN PROCESSING, STORING, AND REPORTING THE MATERIEL, AND DELAYS IN FILLING BACKORDERED REQUIREMENTS.

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IN RESPONSE TO OUR REPORT, THE ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS) AGREED TO DEVELOP PROCEDURES FOR INTER-SERVICE LATERAL REDISTRIBUTION OF RETAIL EXCESS ASSETS AND TO REVISE THE EXISTING POLICY TO ALLOW REIMBURSEMENT FOR THOSE TRANSACTIONS. THE ASSISTANT SECRETARY PROPOSED USING THE EXISTING DEFENSE PROGRAM FOR THE REDISTRIBUTION OF ASSETS AS A BASIC STRUCTURE FOR THE NEW PROCEDURES, PERMITTING MORE RAPID AND ECONOMICAL IMPLEMENTATION OF THE RECOMMENDATION.

SOME EXCESS MATERIEL AT THREE OF THE SEVEN ARMY ACTIVITIES AND ALL SEVEN AIR FORCE ACTIVITIES WE REVIEWED WAS NOT REPORTED TO INTERMEDIATE SUPPORT ACTIVITIES AND WHOLESALE SUPPLY MANAGERS. THE UNREPORTED EXCESS MATERIEL WAS NOT MADE AVAILABLE TO FILL OTHER CUSTOMER REQUIREMENTS. WE RECOMMENDED THAT THE ARMY REQUIRE THAT INTERNAL CONTROLS BE ESTABLISHED TO ENSURE COMPLIANCE WITH ESTABLISHED PROCEDURES. WE ALSO RECOMMENDED THAT THE AIR FORCE REVISE ITS PROCEDURES AND AUTOMATED SYSTEMS TO COMPLY WITH ESTABLISHED DOD POLICY CONCERNING DOLLAR THRESHOLDS FOR REPORTING OF EXCESS MATERIEL. BOTH SERVICES AGREED.

WE WILL TRACK PROGRESS ON THE AGREED-UPON ACTIONS THROUGH OUR AUDIT FOLLOWUP PROGRAM. THE RESULTING IMPROVEMENTS TO THE REDISTRIBUTION PROCESS SHOULD HELP REDUCE UNNECESSARY PROCUREMENTS AND THE INAPPLICABLE INVENTORY.

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CONTRACT TERMINATIONS

IN A SUMMARY REPORT ON "AUDITS OF CONTRACT TERMINATIONS," ISSUED IN NOVEMBER 1989, WE SUMMARIZED THE RESULTS OF A COORDINATED SERIES OF AUDITS BY THE OIG AND GAO FROM NOVEMBER 1985 THROUGH AUGUST 1988. THE IG, DOD, AUDITORS REVIEWED THE PROCEDURES USED BY ARMY AND NAVY INVENTORY CONTROL POINT MANAGERS TO DECIDE WHETHER TO TERMINATE EXISTINC CONTRACTS FOR UNNEEDED SPARE PARTS. THE GAO REVIEWED THE EQUIVALENT PROCEDURES USED BY THE AIR FORCE.

WE CONCLUDED THAT THE SERVICES DID NOT HAVE EFFECTIVE PROCESSES FOR MAKING ECONOMICAL CONTRACT TERMINATION DECISIONS AT INVENTORY CONTROL POINTS. CERTAIN INVENTORY CONTROL POINTS TERMINATED ONLY 2.4 TO 8.6 PERCENT OF THE VALUES OF THEIR EXCESS ON-ORDER ASSETS, WHILE THE AUDITS SHOWED THAT IT WOULD HAVE BEEN MORE ECONOMICAL TO DELETE FROM 36.0 TO 78.0 PERCENT OF SUCH ASSETS FROM CONTRACTS. THE AUDITORS ALSO CONCLUDED THAT THE SERVICES WILL NOT BE ABLE TO ESTABLISH EFFECTIVE AND EFFICIENT TERMINATION DECISIONMAKING PROCESSES UNTIL THEIR MANAGERS CAN ACCURATELY QUANTIFY THE EXCESS ASSETS ON CONTRACTS AND IDENTIFY POTENTIAL TERMINATION COSTS.

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WE ALSO FOUND THAT THE SERVICES DID NOT TAKE ADVANTAGE OF OPPORTUNITIES TO USE EXCESS ON-ORDER ASSETS AS GOVERNMENT-FURNISHED MATERIEL. IN SOME CASES, CONTRACTS HAD PROGRESSED TOO FAR TO ALLOW ECONOMICAL TERMINATION. EVEN IN THOSE CASES, RESOURCES COULD HAVE BEEN SAVED BY TRANSFERRING ABOUT $156 MILLION OF ITEMS TO WEAPON SYSTEM CONTRACTS FOR USE AS GFM.

DURING AND AFTER THE AUDITS, THE SERVICES TOOK NUMEROUS ACTIONS TO CORRECT THE IDENTIFIED PROBLEMS. FOR EXAMPLE, THE SERVICES TERMINATED $29.4 MILLION OF $36.8 MILLION OF EXCESS ORDERS THAT WE AND THE GENERAL ACCOUNTING OFFICE RECOMMENDED FOR IMMEDIATE TERMINATION. THE AIR FORCE DEVELOPED A COST MODEL FOR ITS INVENTORY CONTROL POINTS TO USE IN DECIDING WHEN IT WAS ECONOMICAL TO TERMINATE UNNEEDED ASSETS FROM CONTRACTS. ACCORDING TO DATA PROVIDED BY THE AIR FORCE, THE USE OF THE COST MODEL SUBSTANTIALLY INCREASED THE EXTENT OF CONTRACT TERMINATIONS. BEFORE USING THE NEW MODEL, THE AIR FORCE TERMINATED ONLY $1.8 MILLION (2.4 PERCENT) OF EXCESS ON-ORDER ASSETS THAT THE GENERAL ACCOUNTING OFFICE EVALUATED AT TWO AIR FORCE INVENTORY CONTROL POINTS. USING THE COST MODEL, THE AIR FORCE TERMINATED $116.9 MILLION (17.8 PERCENT) OF EXCESS ON-ORDER ASSETS AT ITS FIVE INVENTORY CONTROL POINTS AS OF MARCH 31, 1988. THE REMAINDER OF THE EXCESS ON-ORDER ASSETS WERE NOT TERMINATED BECAUSE FURTHER REVIEW FOUND A REQUIREMENT FOR THEM OR BECAUSE IT WOULD HAVE COST MORE TO TERMINATE THE CONTRACTS THAN TO RECEIVE AND STORE THE ITEMS.

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS) HAS ISSUED INTERIM GUIDANCE ADDRESSING MANY OF THE SPECIFIC AUDIT RECOMMENDATIONS AND HAS AGREED TO INSTITUTIONALIZE GUIDANCE IN THIS AREA LATER THIS YEAR.

UNDERLYING CAUSES

MR. CHAIRMAN, YOUR INVITATION LETTER REQUESTED MY VIEWS ON THE UNDERLYING CAUSES OF THE GROWTH OF UNREQUIRED INVENTORIES AND WHAT ACTIONS ARE NEEDED.

THERE ARE NUMEROUS REASONS WHY INAPPLICABLE INVENTORY CAN GROW. THESE INCLUDE:

1. PRICE INCREASES. AS THE SOPHISTICATION AND COST OF WEAPON SYSTEMS AND OTHER DOD EQUIPMENT GROW, SO DOES THE COST OF SPARE AND REPAIR PARTS. CURRENTLY, THIS IS A LESS IMPORTANT FACTOR THAN IT WAS DURING THE EARLY 1980'S.

2. CHANGES IN OPERATING TEMPO, FORCE STRUCTURE, OR FORCE DEPLOYMENT. MAINTAINING HIGH OPERATING TEMPO WHILE PUTTING A PREMIUM ON READINESS PLACES HEAVY DEMANDS ON THE SUPPLY SYSTEM AND ESTABLISHES HIGH DEMAND PATTERNS. RECENT CUTBACKS PROBABLY HAVE ALREADY CAUSED SOME FALL-OFF IN PREVIOUSLY FORECASTED DEMAND; HOWEVER, THERE COULD BE A DRASTIC CHANGE IN THE FUTURE DUE TO SOME OF THE FUTURE DEFENSE SCENARIOS BEING DISCUSSED.

SINCE THE SUPPLY SYSTEM HAS NOT DONE WELL IN DEALING WITH EVEN RELATIVELY MINOR DECREASES FROM HISTORICAL DEMAND PATTERNS, THE LEVEL OF INAPPLICABLE INVENTORY IS LIKELY TO INCREASE EVEN MORE.

3. WEAPON SYSTEM MODERNIZATION AND PHASEOUT OF OBSOLETE SUPPLIES OR SYSTEMS. NUMEROUS MODERNIZATION PROGRAMS WERE ACCELERATED OR INITIATED IN THE 1980'S. PARTS FOR OBSOLETE EQUIPMENT AND OBSOLETE SUPPLY ITEMS MIGRATED TO THE INAPPLICABLE INVENTORY CATEGORY.

4. RESTRICTIVE DISPOSAL POLICY. THE MID-1980'S FREEZE ON DISPOSING OF ITEMS RELATED TO ACTIVE WEAPON SYSTEMS EXACERBATED THE PROBLEM FOR THE DOD. THIS IS A GOOD EXAMPLE OF WHERE ONE SET OF CORRECTIVE ACTIONS CREATES OTHER DIFFICULTIES. THE OFFICE OF THE INSPECTOR GENERAL AND THE CONGRESS BOTH SUPPORTED THE VIRTUAL MORATORIUM, WHICH WAS IMPOSED BY DOD FOLLOWING DISCLOSURES OF LOOSE CONTROLS IN THE DEMILITARIZATION AND DISPOSAL PROCESSES.

5. INCREASED PROCUREMENT LEADTIMES. THE ACQUISITION REFORM MEASURES OF THE PAST SEVERAL YEARS HAVE INCREASED PROCUREMENT LEADTIMES. LONGER LEADTIMES INCREASE THE PROBABILITY OF INACCURATE REQUIREMENTS FORECASTING. THE SUPPLY SYSTEM IS SUPPOSED TO HAVE CORRECTING MECHANISMS, HOWEVER. AS NOTED IN MY PREVIOUS REMARKS ON THE FREQUENT FAILURES TO TERMINATE CONTRACTS FOR EXCESS ITEMS, THE PRESCRIBED PROCEDURES FREQUENTLY HAVE NOT BEEN FOLLOWED.

6. SLOW TURNOVER. THERE IS A COMMON MISPERCEPTION THAT MOST OF DOD SUPPLY INVENTORIES TURN OVER QUICKLY (OR, IF THEY DO NOT, THAT SOMETHING IS WRONG). ON THE CONTRARY, OVER 90 PERCENT OF SECONDARY ITEMS ARE NATURALLY SLOW MOVING ITEMS. THE DIFFICULTY IN MANAGING SLOW MOVING STOCK IS THAT, IF AN OVER-STOCKED SUPPLY SITUATION DEVELOPS, THE SYSTEM CAN ONLY "CORRECT" ITSELF IN THE SHORT TERM THROUGH DISPOSAL OF THE EXCESS ITEMS. DISPOSAL OF AN ITEM THAT COULD HAVE EVENTUAL USE INVOLVES RISK, SINCE DEMAND IS SO HARD TO FORECAST. MOREOVER, THE PROCEEDS FROM DISPOSAL RARELY COVER THE COSTS OF THE PROCESS, WHEREAS CONTINUED STORAGE COSTS ARE MINOR WHEN COMPARED TO REPROCUREMENT COSTS.

7. DISUSE OF ECONOMIC ORDER QUANTITY CALCULATIONS. IN AN ATTEMPT TO DRIVE DOWN PER UNIT COSTS AND ADMINISTRATIVE PROCUREMENT COSTS AS MUCH AS POSSIBLE, THE DOD WAIVED REQUIREMENTS FOR LIMITING PROCUREMENT QUANTITIES TO EOQ LEVELS BETWEEN EARLY 1986 AND LATE 1989. THAT POLICY MAY HAVE GENERATED SAVINGS, BUT IT ALMOST CERTAINLY INCREASED THE NUMBER OF ITEMS IN LONG SUPPLY AS WELL.

8. OTHER PROCEDURAL WEAKNESSES. AS I DISCUSSED PREVIOUSLY, OUR AUDITS INDICATE THAT THE PROCESSES FOR IDENTIFYING AND REDISTRIBUTING EXCESS ONHAND ASSETS HAVE BEEN INADEQUATE, AS HAVE THE PROCESSES FOR IDENTIFYING EXCESS QUANTITIES OF ON-ORDER ITEMS AND MAKING COST EFFECTIVE TERMINATION DECISIONS.

9. IMBALANCED EMPHASIS. SUPPLY PERSONNEL ARE SCHOOLED IN THE CONCEPT THAT TIMELY SERVICE TO THE CUSTOMER IS THE PARAMOUNT CONSIDERATION. IN A MILITARY ORGANIZATION, THAT IS UNDERSTANDABLE AND LAUDABLE. THE MESSAGE NEEDS TO BE TEMPERED, HOWEVER, ESPECIALLY IN PEACETIME, WITH AN EQUAL CONCERN FOR ECONOMY AND EFFICIENCY. PARADOXICALLY, THE HEAVY EMPHASIS ON AVOIDING UNREASONABLY HIGH PRICES FOR INDIVIDUAL SPARE PARTS MAY HAVE DILUTED THE EVEN MORE FUNDAMENTAL MESSAGE THAT WE NEED TO BUY ONLY WHAT IS CLEARLY REQUIRED. LIKEWISE, WE NEED TO ESCAPE FROM THE MIND-SET THAT HAMPERS EFFICIENCY IN PROGRAMS THROUGHOUT THE GOVERNMENT--I AM REFERRING TO THE PERCEIVED IMPERATIVE TO OBLIGATE AND EXPEND 100 PERCENT OF BUDGET ALLOCATIONS. WE LACK AN EFFECTIVE MEANS OF REWARDING THE MANAGER WHO SPENDS PRUDENTLY AND WHO ACHIEVES SAVINGS THROUGH TIMELY CANCELLATIONS, REDISTRI-BUTIONS, AND OTHER MEASURES TO MINIMIZE EXCESS INVENTORIES. INDEED, WE COULD CONSIDERABLY CHANGE THE SIGNALS SIMPLY BY NOT AUTOMATICALLY CUTTING FUTURE BUDGET REQUESTS FOR PROGRAMS THAT DO NOT SPEND EVERY APPROPRIATED DOLLAR AS SOON AS THEY CAN.

10. INACCURATE DATA AND CONTROLS. DATA ERRORS AND INADEQUATE LOCAL CONTROLS HAMPER EFFICIENT SUPPLY OPERATIONS. OUR AUDITS ARE FOCUSED ON EVALUATING THE DATA AND CALCULATIONS MOST RELEVANT TO THE DECISIONMAKERS IN THE SUPPLY PROCESS--HISTORICAL DEMAND DATA AND ECONOMIC ORDER QUANTITY CALCULATIONS,

FOR EXAMPLE. CURRENTLY, WE HAVE AUDIT TEAMS CONCENTRATING ON REQUIREMENTS DETERMINATION PROCESSES, WHICH MUST BE EFFICIENT IF WASTEFUL SPENDING IS TO BE AVOIDED.

RECOMMENDATIONS

AS THE DEPARTMENT OF DEFENSE ENTERS INTO A PERIOD OF SUSTAINED DECLINE IN RESOURCES AND AS THE TEMPO OF MILITARY OPERATIONS DECREASES, THE MANAGERS OF THE DEFENSE SUPPLY SYSTEM FACE AN ENORMOUS CHALLENGE. THEY MUST MANAGE A SHRINKING MILITARY SUPPLY SYSTEM WITHOUT JEOPARDIZING OPERATIONAL READINESS.

THERE ARE NO SIMPLE SOLUTIONS OR QUICK FIXES TO PROBLEMS THAT HAVE BEEN IDENTIFIED IN THE SUPPLY SYSTEM. MANY DIFFERENT ACTIONS ARE NEEDED TO IMPROVE THE DOD SUPPLY MANAGEMENT AND TO AVOID THE EVEN LARGER PROBLEMS THAT COULD BESET THE SYSTEM IN THE FUTURE, SINCE SUPPLY SYSTEM PROCEDURES AND ESTIMATING METHODOLOGIES ARE NOT GEARED FOR FUNCTIONING IN AN ENVIRONMENT OF DECREASING DEMAND. THE CONGRESS AND THE DOD MUST MAINTAIN A CLOSE FOCUS ON THE SUPPLY MANAGEMENT AREA, BUT NOT OVERREACT. A PELLMELL RUSH TO DISPOSE OF LONG SUPPLY ITEMS, FOR EXAMPLE, COULD SWAMP THE DISPOSAL APPARATUS, LEAD TO INADEQUATE DEMILITARIZATION, DEGRADE MANAGEMENT CONTROLS, AND NOT RESULT IN ANY APPRECIABLE FINANCIAL GAIN TO THE GOVERNMENT.

MY SPECIFIC RECOMMENDATIONS ARE:

1. DOD MUST PROVIDE CLEAR AND REASONABLE GUIDANCE CONCERNING THE DISPOSAL OF SUPPLY ITEMS RELATED TO ACTIVE WEAPONS SYSTEMS.

2. DOD MUST ENSURE THAT BALANCED, ADEQUATE POLICY GUIDANCE IS PROVIDED TO SUPPLY MANAGERS AND ENFORCED. THE GUIDANCE MUST STRESS THE NEED FOR ECONOMY, AS WELL AS CUSTOMER SERVICE, AND THERE MUST BE SUSTAINED, VISIBLE TOP MANAGEMENT COMMITMENT TO ACHIEVING LASTING IMPROVEMENTS.

3. DOD MUST PUT GREATER EMPHASIS ON COMPLETING THE MANY CORRECTIVE ACTIONS TO WHICH IT HAS AGREED IN RESPONSE TO GAO AND DOD AUDITS.

4. DOD MUST CONTINUE THE EMPHASIS ON LOGISTICS MANAGEMENT THAT IS EVIDENT IN THE DEFENSE MANAGEMENT REPORT IMPLEMENTATION INITIATIVES. I SUPPORT THOSE DMR INITIATIVES AND THE NUMEROUS OTHER ONGOING MANAGEMENT IMPROVEMENT PROJECTS THAT ADDRESS THE KINDS OF PROBLEMS I HAVE DISCUSSED TODAY. THE DEPARTMENT MUST ENSURE, HOWEVER, THAT THE STREAMLINING OF POLICY GUIDANCE UNDER THE DMR INITIATIVES DOES NOT CREATE POLICY GAPS IN THE AREA OF SUPPLY MANAGEMENT.

IN CONCLUSION, I EMPHASIZE THAT THERE IS NO SUBSTITUTE FOR ATTENTION AND COMMITMENT FROM TOP DOD MANAGERS. STRONGER POLICY ENFORCEMENT MUST BEGIN AT THE TOP! HIGH LEVEL COMMITMENT IS ESPECIALLY CRITICAL IN VIEW OF A DECLINING BUDGET. WE MUST PRUDENTLY, ACTIVELY MANAGE THE PLANNED, SUSTAINED DECLINE IN DEFENSE RESOURCES, OR THE PROBLEMS WE SEE TODAY WILL SURELY BE EXACERBATED. I WILL CONTINUE TO PLACE HEAVY AUDIT, INSPECTION AND FOLLOWUP COVERAGE ON THIS AREA AND TO KEEP THE CONGRESS AND DOD FULLY INFORMED OF THE RESULTS. THAT CONCLUDES MY STATEMENT.

JOHN GLENN, OHIO, CHAIRMAN
SAM NUNN, GEORGIA
CARL LEVIN, MICHIGAN
JIM SASSER, TENNESSEE
DAVID PRYOR, ARKANSAS
JEFF BINGAMAN, NEW MEXICO
HERBERT KOHL, WISCONSIN
JOSEPH I. LIEBERMAN, CONNECTICUT
WILLIAM V. ROTH, JR., DELAWARE
TED STEVENS, ALASKA
WILLIAM S. COHEN, MAINE
WARREN B. RUDMAN, NEW HAMPSHIRE
JOHN HEINZ, PENNSYLVANIA
PETE WILSON, CALIFORNIA
LEONARD WEISS, STAFF DIRECTOR
JO ANNE BARNHART, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

April 20, 1989

CAN you make your AF correspondence part of the record

The Honorable James F. McGovern
Acting Secretary of the Air Force
Department of Defense
The Pentagon
Washington, D. C. 20301

Dear Mr. McGovern:

As Chairman of the Governmental Affairs Committee, in the 100th Congress I released a Committee report on problems in managing the Department's supplies. A copy of that report is enclosed. The report expressed the hope that voluntary reforms would help reduce unnecessary inventory growth. I was particularly concerned with the growth in "long supply", an informal term for stocks with "no known present peacetime or wartime requirement". Long supply was of particular concern because it grew from approximately $10 billion in 1980 to $30 billion in 1987. Since that report was finalized, the Committee has received disturbing information that raises questions about the Department's commitments to reform.

Since 1980, aircraft parts growth has been the single largest area of growth in the Department's $94 billion secondary item inventory. The Air Force itself has expressed concern that too much of the growth was in unrequired stocks, and the Air Force was criticized in the report for its failure to terminate hundreds of millions of dollars in on-order excess. Allegedly, the Air Force logistics Command recently had its inventory managers add requirements into Air Force computers corresponding to the amount of certain unneeded stocks on order and already on hand. While this may result in the excess "disappearing", it does not change the potential waste of government money.

Information available suggests that these changes were made to reduce the amount of aircraft items reported as unneeded. The changes would understate unneeded aircraft items by more than $1 billion and may increase the risk of buying even more unneeded items. Additional planned changes could further understate the amount of unneeded stocks and reduce the credibility of Air Force requirements.

These problems appear to result directly from headquarters guidance, and hence, are especially distressing. An April 7, 1988, Air Force headquarters memorandum provided guidance on "Inventory Stratification and Analysis" to the Air Force Logistics Command. The memorandum emphasized the urgency of needed analyses and recategorization, and provided such specific guidance as, "As a minimum, the AFAO and termination point should be extended."

The Air Force Logistics Command responded to this direction in May and June, describing interim plans to add requirements for unneeded items on-order and on-hand if managers believed terminating the orders would be uneconomical. Most of the Command's field activities managers agree with the interim plan. For example, one responded in May that:

> "We believe your improved method will have a positive effect on your budget position. Congress had continually voiced skepticism over the Air Force's capability of stating valid spare requirements when they continue to see our excess positions. Unfortunately, this is a legitimate assumption on their part, when our excess continues to appear. The implementation of using an additive for the termination quantities to reduce our excess is excellent. Restratification of our excess by eliminating the visibility will safeguard our budget dollars."

However, other field activities managers voiced concerns about the potential for abuse, and raised the question of whether everyone would agree that it is proper to recategorize unneeded items to become required items. One manager asked:

> "When this [inventory] report is prepared and the assets move from potential DOD excess to the requirements segment, do you think anyone (Senator Glenn) may ask why?"

I am asking why. It appears that the Department, and particularly the Air Force, have been buying too many items before they are needed. With such convoluted logic as reflected in these initiatives, including justifying more items with "no known current or wartime need", it may be an area where you can obtain needed savings.

I had hoped that the Air Force had embarked on an honest effort to solve the difficult problems underlying the excess growth of unneeded supplies. If, in fact, even part of the Air Force's initiative is aimed at sweeping these matters under the rug, it would be most distressing.

I urge you to investigate any evidence of disregard for the integrity of the supply system and to order the headquarters officials responsible to retract the guidance that is causing such incidents.

Should you have any questions regarding this matter, please call me at any time. If your staff is interested in discussing this with my staff, they can contact Stephen Ryan at 224-4751. Thank you for your cooperation.

Sincerely,

John Glenn
Chairman

JHG/smr

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

MAY 10 1989

The Honorable John Glenn
United States Senate
Washington, D.C. 20510-0001

Dear Senator Glenn,

This is in response to your letter of April 20, 1989, to the Acting Secretary of the Air Force. Your letter expresses concern that the Air Force may not be sufficiently committed to controlling inventory growth. You cite several actions by our Air Force Logistics Command which have the appearance of "sweeping these matters under the rug", and urge that we investigate any evidence of disregard for the integrity of the supply system.

First, let me assure you that it is not our intention to mislead. I also will be the first to admit that our inventory management systems, both automated and human, are not perfect. It does appear that there has been some unwarranted inventory growth. On the other hand, much of the apparent inventory growth from 1980 to 1987 is explainable. There are some very complex issues involved.

In this letter I shall: (1) put the inventory growth into perspective; (2) address the termination policy concerns raised in your letter; and, (3) describe our objectives and plans for the future.

Growth in Inventory and Long Supply

There are five primary causative factors for the growth in inventory and long supply from 1980 to the present. These are inflation; full funding of peacetime (1984-present) and wartime (1984-1986) requirements compared to significant underfunding in the 1970s; phase-down of older aircraft without commensurate disposal of applicable inventory; accelerated acquisition of new weapon systems during the decade; and, procurement of economic order quantities in excess of a single year's needs.

Unfortunately, our data systems do not provide an easy means to quantify the effects of each of these causative factors. Also, the numbers in your letter (i.e., that growth in long supply was from $10B in 1980 to $30B in 1987) appear to be for the entire Department of Defense, not just Air Force. Accordingly, we have elected to address only Aircraft Spares (BP15) which, as you point out in your letter, is the single largest area of growth.

AIRCRAFT SPARES (BP15) ($Billion)

	FY80	FY87	FY88
Total Inventory	10.5	25.6	28.5
Long Supply	2.5	5.9	7.6
Inventory Growth		+15.1	+18.0
Long Supply Growth		+ 3.4	+ 5.1

Inflation from 1980 to 1988 has been 33%, which is $.8B of the growth. In addition, $4.9B (62%) of the FY88 long supply is in an unserviceable condition*. This largely represents inventory pertaining to phased-out aircraft. The combination of these factors ($5.7B) could alone account for the growth in long supply.

Regarding the inventory growth, some small portion would also result from the effects of inflation. However, the bulk is associated with the acquisition of new weapon systems including F-16s, F-15s, B-1s, KC-10s, C-5s, C-130s and others, including major modifications to existing systems such as KC-135 re-engining, B-52 avionics, etc. The initial lay-in of stocks to support these new weapon systems involved an inventory investment of $16.5B.

In summary, we do not share your concern that growth in either inventory or long supply is out of proportion to the modernization of our armed forces during the Reagan Administration.

Termination Policy Concerns

Computers of the Air Force Logistics Command are programmed to project stockage requirements for an "execution" year. These requirements are known as the AFAO (Approved Force Acquisition Objective). Depending on procurement lead times, this "execution" year may be 24-36 months in the future. Once an order has been placed, and as we move forward in time closer to the "execution" year, there are several factors which may cause the on order quantity to appear in excess to actual needs and cause the computer to generate a "termination notice".

First, in 1984 the Air Force implemented an aggressive program to reduce unit prices. This action caused the Air Force to seek optimum and economic order quantities which would result in the lowest unit prices. The net result is that buy quantities sometimes exceed the requirements of the execution year. Unfortunately, we have not been able to reprogram our computers to

*Note: Although unserviceable items are carried in inventory at the full catalog price, on the average it costs 30-50% to effect repair and to restore to a serviceable condition. Hence, this portion of the inventory is actually overvalued.

reflect that the authorized AFAO has been extended beyond the twelve month "execution year" for that item.

Second, and especially for new items, the buy quantity is frequently based on an engineering estimate. For various reasons, ranging from delayed activation of the new weapon systems to greater reliability (hence, fewer item failures*) than predicted, demand/usage does not generate at the estimated rate. When failures do not generate, a stockage requirement will not compute, and this makes the items, whether on hand or on order, appear excess to need. The solution to this is to establish numeric stockage objectives for the first few years. Again, because of our ADP difficulties, we have not established such numeric stockage objectives, but have authorized the use of "additives". Unfortunately, the use of "additives" is labor intensive, not only with respect to their initial establishment, but also to keep them current (i.e., to phase them down as demand-based stockage requirements phase up).

Finally, as the "execution" year is entered, the computer will only consider the remaining months of that year as part of the AFAO. In effect, an on-order quantity to be delivered late in that year, or which is late to schedule and may deliver beyond the year, frequently computes as excess and will result in generation of a "termination notice".

For these reasons, when the computer generates a "termination notice", the most frequent decision is to continue the procurement action. This action is not taken, however, without a validation of need by the item manager. During each subsequent review cycle until the items are delivered or demand catches up, "termination notices" will generate and an item manager review will occur. The net result is wasted administrative effort. For these reasons, in April, 1988, action was taken to authorize the use of additives to provide for extending the "execution" period. The use of additives would preclude repetitive generation of termination notices for the same item after the initial review and determination that the procurement should continue. This action, which has only been partially implemented, would reduce the number of "termination notices" and, as you indicate, would also more properly stratify inventory as "required" rather than as long supply or excess. Believe me, this is not an effort to "cover up" or "to sweep long supply under the rug", but rather to more accurately portray the status of our inventory.

I am personally very concerned about the perception that our inventory contains inordinate amounts of inapplicable (long supply) assets. If anything, our performance data (undesirable levels of backorders and declining supply availability) indicates the opposite. It is my personal view that our operating and

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*Many items also generate more failures than predicted, but their inventory does not stratify as long supply!

safety levels are inadequate, but I do not yet have the means of effectively assessing and remedying that situation. You are also aware, I am sure, that War Reserve requirements in support of new systems and major modifications to existing systems have been virtually unfunded since 1986. This consideration also militates against termination of orders in support of newer aircraft. The use of "additives", where items have been ordered to support active weapons systems, is a stop-gap measure at best. We will do better.

Objectives and Plans for the Future

We have given the following guidance to the Air Force Logistics Command:

(1) Improve the accuracy of the inventory summaries reported in the stratifications and in reports to OSD.

(2) Manage terminations with more timely reviews, use a termination decision model, and report progress.

(3) Change the computation system to avoid perturbations and turmoil in spares procurement (e.g., minimize "buy/terminate/buy again" actions for the same items).

(4) Analyze the reasons for inventory growth, with accurate numbers, so management can assess the adequacy of our buy and retention policies.

The Termination Decision Model has been completed and is now being used by item managers. Regrettably, the Air Force Logistics Command has advised that the major ADP changes contemplated by these objectives cannot be implemented before 1994. I have asked them to try harder, and to give these needed changes higher priority, and to implement them piecemeal if necessary.

There is one other issue which we must yet address; viz., our disposal practice. Currently, although most aircraft of a particular MDS (model/design/series) have been phased out, we retain all assets of items used in that aircraft so long as one or more aircraft of that MDS remain in active use. In other words, for many items we consciously retain 15-20 years worth of inventory that most probably will never be needed. This includes much of the 62% of long supply which is unserviceable. We are asking the Air Force Logistics Command to evaluate this issue and to make recommendations for change to our current retention procedures.

Since 1986, when the GAO first looked at our termination policies and procedures, we have seriously and continually addressed the issue. As you can see from the foregoing discussion, this is a complex business and there are no easy answers. However, I can categorically state that our item managers have been sensitized to the issue, and are encouraged to effect termination actions when appropriate. In fact, the percentages actually being terminated

have increased, while the value of potential termination orders has decreased from $.9B (12% of on order) in FY87 to $.7B (9% of on order) in FY88. My concern is that we only terminate where a true excess position exists; it does not make sense to terminate, and then to reinitiate the buy 6-18 months later.

I look forward to continuing dialogue with your staff on this matter, and will be pleased to arrange for them to visit one or more of our Air Logistics Centers. Also, I can appreciate that it strains credibility to deprecate our ADP capability at a time when we are spending considerable sums to modernize our logistics management computer systems. Here again, I will be pleased to make available our experts to discuss this aspect of the problem with your staff in greater detail.

LLOYD K. MOSEMANN II
Deputy Assistant Secretary
(Logistics)

DEFENSE MANAGEMENT REPORT IMPLEMENTATION PROGRESS REPORT

President Bush, in his February 1989 address to a Joint Session of Congress, charged the Secretary of Defense with undertaking a review of defense management practices. In response, Secretary Cheney sent the Defense Management Report (DMR) to the President in July 1989. The DMR provided a plan to implement fully the Packard Commission recommendations; improve substantially the performance of the defense acquisition system; and manage more effectively the Department of Defense and the defense resources.

The DMR called for the Deputy Secretary of Defense, the Secretaries of the Military Departments, the Chairman of the Joint Chiefs of Staff, the Under Secretary of Defense for Acquisition (USD(A)), and the Under Secretary of Defense for Policy (USD(P)), as the senior managers within the Department of Defense, to undertake a broad range of actions to carry out the President's charge.

The implementation process established for the DMR provides for continuous improvement of defense management. Accomplishing the full set of objectives will require several years of significant effort. This progress report highlights the first generation of DMR implementation actions. These efforts are designed to achieve six broad goals:

1. Reduce overhead costs while maintaining military strength;
2. Enhance weapon systems program performance;
3. Reinvigorate the planning and budgeting process;
4. Reduce micromanagement;
5. Strengthen the defense industrial base; and
6. Improve observance of ethical standards in government and industry.

Reduce overhead costs while maintaining military strength

The Department is implementing a significantly more streamlined acquisition management structure with clear lines of responsibility and authority running from the USD(A) through full-time Service Acquisition Executives (SAEs) and full-time Program Executive Officers (PEOs) to individual Program Managers (PMs). Each Military Department has developed a plan for and is now streamlining its acquisition management structure in a manner consistent with the DMR.

The Services' systems and materiel commands will be reorganized with a primary focus on three roles: to provide service logistics support, to manage programs that fall outside the PEO structure, and to provide a variety of support services to the PEOs and PMs. The revised structures will eliminate layers of

supervision and functions that add little or no value to the overall management of DoD and should improve the efficiency of the acquisition and logistics systems.

Nearly all contract administration services (CAS), currently divided among the three Military Departments and the Defense Logistics Agency (DLA), will be consolidated under DLA. This action will result in a streamlined CAS organization that will promote uniform implementation of acquisition policies and regulations and will result in savings of both dollars and manpower. Consolidation under DLA was chosen over creation of a new Defense agency in order to avoid the significant overhead costs associated with establishing a new management structure. The remaining CAS operations will also be reviewed for possible consolidation and additional streamlining opportunities.

A Corporate Information Management initiative is underway to develop more efficient and effective data processing and information systems, eliminate duplication of effort in information management, and ensure that the systems support policy goals and timely decision-making. This initiative will benefit from the advice of experienced and creative information management specialists in both industry and the DoD.

Through these and other similar efficiency efforts, DoD will realize a total reduction of approximately 18,000 civilian and 24,000 military personnel in acquisition and management positions by the end of 1995. DoD will make a concerted effort to manage the reductions and consolidations through attrition and relocation. These numbers represent a true streamlining, because personnel requirements at all levels will be reduced as efficiencies are achieved.

Personnel reductions, organizational streamlining, and improved efficiencies resulting from better management control systems, will bring about reductions in the cost of managing the Department of Defense. The current estimate is that DoD will save approximately $2.3 billion in FY 1991 and $39 billion over the period from FY 1991 through FY 1995 from the five-year Defense budget as amended in April 1989. The savings represent a significant down payment toward the revised administration spending targets. In addition to the savings described above, one adjustment alone in how the Department finances and manages reparable parts will enable DoD to make more efficient use of $2.8 billion of budget authority in FY 1991.

Streamlining efforts are the result of a continuing, thorough approach to eliminate unnecessary layers of personnel and non value-added functions. Study groups are currently investigating possibilities for consolidation or further streamlining of: supply depots; maintenance depots; inventory control points; accounting operations; research and development laboratories and test facilities; and automated data processing design centers and operations. These groups will report their findings and recommendations to the Deputy Secretary of Defense by May 1, 1990. In addition, the Department will continue to extend efforts to increase efficiency in other sectors of DoD management.

Finally, programmatic force structure reductions are under consideration for future years. If changes in the world situation and the results of international negotiations permit those programmatic reductions to occur, DoD may be able to realize further reductions in management support structures and associated costs.

Enhance weapons systems program performance

The USD(A) has the charter to discipline programs through a revised and strengthened 4-phase acquisition process. Programs must successfully achieve defined milestones and specific exit criteria set by the USD(A), with the advice of the Defense Acquisition Board (DAB). Clear policies guiding this revised process have been issued.

In addition, the Joint Requirements Oversight Council (JROC), chaired by the Vice Chairman of the Joint Chiefs of Staff, has assumed a broader role in the articulation of military requirements and the validation of performance goals and baselines for all DAB programs. Working through the DAB and JROC, the USD(A) will ensure that complex systems reflect a proper combination of cost, schedule and performance parameters.

The military departments have developed plans to create dedicated corps of officers who will make acquisition a full-time career. They will be provided specialized education and training, attractive and equitable career paths, and opportunities for promotion to the highest ranks. Among actions to improve the civilian workforce will be efforts to enhance recruitment and retention, provide career-related education and professional rewards, and increase professionalism within the acquisition-related fields.

The streamlining of the acquisition management structure is designed to improve the flow of information between program managers (PMs) and the Department's senior decision-makers. To help keep the management lines clear, and to assist the PMs, a task force was formed to evaluate the effect of single-interest program advocates within DoD. These advocates are functional experts (transportation, packaging, metrification,etc.) who can pose restrictions but who possess no integrating authority or responsibility for the program process and tend to make the acquisition system less efficient. This task force and the Regulatory Relief Task Force (described below) independently examined 148 DoD-level directives and instructions which tend to diminish the PM's ability to exercise authority. The Advocacy Reduction Task Force Interim Report recommends that 104 of these advocacy-related issuances be canceled outright or canceled and combined with other issuances. When taken together with the regulatory reduction, these internal changes will reduce significantly the self-imposed constraints on sound program management.

Although much has been accomplished in this area, there is considerably more which needs to be done. The USD(A) will continue to develop a unified and significantly streamlined set of acquisition policy guidance. The goal is a simplified acquisition system, run by well trained, dedicated professionals who are able to perform their function with a minimum of bureaucratic distraction. Authority and responsibility will be pushed down through the program management chain to the program managers who will, in turn, be held increasingly accountable for the product of their efforts.

Reinvigorate the planning and budgeting process

The Secretary chairs a new Executive Committee consisting of the Deputy Secretary, Secretaries of the Military Departments, Chairman of the Joint Chiefs of Staff, and the two Under Secretaries of Defense. The Executive Committee reviews overall Department policies and permits regular and confidential exchanges on key issues among the Department's senior leadership.

In addition, the Deputy Secretary manages a revitalized planning, programming and budgeting system as Chairman of the Defense Planning and Resources Board (DPRB). Through DPRB discussions the senior leadership in DoD has engaged in a dynamic planning process that will, over time, improve the Department's ability to link policy, strategy, programs, and budgets through such

tools as a restructured Defense Planning Guidance (DPG). The USD(P) serves as the primary advisor to the Deputy Secretary for the planning phase and the preparation of the DPG. A new DPG is being prepared which reflects the dynamic world events of recent months. This process forms the basis of an ongoing review of defense issues which will serve as groundwork for the establishment of the defense program for the next six-year period.

In addition, the USD(P) has been given an larger role in the DPRB to ensure that policy and strategy considerations are integrated throughout the programming and budgeting phases. This process has already proven successful in developing plans to expand DoD's role in countering the production and trafficking of illegal narcotics, in supporting the reformulation of overall defense strategy in a rapidly changing world environment, and in the establishment of a significantly reduced FY 1991 Defense budget.

The DPRB discussions will play a vital role in providing better links among national policies, military strategy, and defense programs. To support this effort, the USD(A) will play an increased role in the resource allocation process to establish tight links between program and resource planning.

Reduce micromanagement

The DMR charged the USD(A) with assembling a joint task force to evaluate the effect of internal regulations on the acquisition process. A Regulatory Relief Task Force of nine working groups has achieved impressive results from its exhaustive effort. The task force reviewed a bewildering maze of self-imposed regulations.

For example, of the more than 1,200 DoD directives and policy memoranda reviewed, 512 were determined to affect the acquisition system. The Regulatory Relief Task Force has reviewed 383 of these documents and has recommended elimination of 61; cancellation or combination of 176; revision of 63; and retention, as is of only 83. In the procurement and contracting area, the task force has recommended the cancellation, combination, or revision of 64% of the 431 Defense Federal Acquisition Regulation Supplement (DFARS) contract clauses, 79% of the lines in the 66,665 lines of DFARS text, 76% of the 80 Military Department and DoD Agency contract clauses, and over 52% of the 44,057 lines of Military Department and Defense Agency text.

Finally, questionnaires have been distributed on over 50,000 specifications and standards and related documents for review. The task force has focused its initial review on about 1,500 high payoff standards with the most promising potential for increased efficiency.

In an effort to reduce internal micromanagement, the Department will overhaul completely the system of acquisition directives and instructions. A new streamlined set of documents is expected to be issued by July 1990 in a form that permits implementation at the program manager and field operating level, with minimal additional policy guidance. In addition, guidance relating to procurement and contracting will be completely restructured and streamlined by February 1991 with the publication of a new Defense Federal Acquisition Regulation Supplement. The task force will submit final recommendations on key Defense acquisition standards by April 1990 with recommendations due on the remaining body of specifications and standards by December 1990. To institutionalize the philosophy of reduced micromanagement, the USD(A) will develop recommendations to improve the process by which DoD-level documents are developed and issued.

A legislative task force was chartered under the direction of the Legislative Counsel and former Secretary of the Army, Jack Marsh, to review existing statutes and to recommend changes that would improve DoD efficiency. The task force's report recommends legislation to improve the management of:

- production, acquisition, and logistics;
- military and civilian personnel;
- environment; and
- departmental finances.

DoD will be working with the Office of Management and Budget and the Office of Personnel Management, among other agencies, to develop the Administration's legislative package.

The report also calls on Congress to work with the Administration to review and overhaul the statutory framework for DoD acquisition. To aid in this effort, the report suggests specific themes that should guide such an effort.

As called for in the DMR, a White Paper on DoD and Congress is being sent to the President which emphasizes the need for cooperation between the executive and legislative branches on defense issues.

Strengthen the defense industrial base

The contractors that comprise the defense industry will play a vital role in our future defense efforts. The industrial base must be strong, and include manufacturers that are highly flexible, technologically advanced, and ever-creative if DoD is to fulfill its mission of defending the Nation in the years ahead. This will require that both DoD and industry maintain active research programs in vital technologies that will be particularly critical in the future.

In order to strengthen this industrial base, DoD must create incentives (and eliminate disincentives) to invest in new facilities and equipment as well as in research and development. One tool of particular importance in this regard will be continued DoD support of independent research and development efforts in industry.

The quality of end products and the productivity of defense manufacturers can be improved through the use of contract mechanisms that reduce unnecessary financial risk. For example, the Department will restrict severely the use of fixed-price development contracts. Such contracts, which are restricted for programs over $10 million, tend to put contractors in the untenable position of developing high-risk programs at a fixed price. This tends to inhibit exploration and innovation early in a program when changes in design can be made more effectively at a much lower cost. Likewise, cost-sharing arrangements would be given similar scrutiny and subject to limitations.

In addition, DoD is fostering better performance by defense contractors through the proper control of technical configuration and by developing sound policies on profitability and progress payments. Finally, the Department is developing a contractor performance review system that will permit a more thorough consideration of past performance in source selection and thereby promote contracting relationships with suppliers with solid histories of performance.

Improve observance of ethical standards in government and industry

The Secretary chartered a DoD Ethics Council consisting of the USD(A) and the Secretaries of the Military Departments to develop ethics programs for the Department. The Council has met and established a joint working group headed by the Director, Ethics Training and Communications Policy to:

1. Develop a proposed model ethics program for DoD (including education and training).

2. Develop a plan for a DoD-wide Ethics Conference.

3. Review existing compliance programs for needed enhancements.

The results of these efforts are to be provided to the Council for review in January 1990.

The Department is considering a proposal to revise fundamentally the process of industry compliance and government oversight in procurement matters. The proposal calls for a demonstration program in which several Defense contractors enter into specific compacts with the relevant federal government agencies. Each compact would be based upon complementary commitments from both the firm and government in the areas of: (a) compliance and enforcement; and (b) oversight auditing of a contractor's financial and systems performance. DoD will begin developing this proposal with other interested government agencies in the near future.

The goal of these efforts is to strengthen the observance of ethical standards within government and with industry and to create an environment where official standards of conduct are well understood, broadly observed, and vigorously enforced.

Improving Defense Management

The strength of the DMR process and its relative advantage over earlier efforts to change management techniques and structures within the Department is that the DMR is a product of the Department itself, not something forced on it from outside. The people - both civilian and military - who developed the changes described above will be the same people called upon to make those changes work. The changes are not quick fixes but rather fundamental shifts, "cultural changes," that address the

issues at the core of defense management. While it may take time to realize fully the extent of the changes associated with DMR, we are proud of the accomplishments to date. This is the first DMR Implementation Progress Report.

The Department's leadership is committed to improving defense management by:

- reducing overhead while maintaining military strength;
- enhancing weapon systems program performance;
- reinvigorating the planning and budgeting process;
- reducing micromanagement;
- strengthening the defense industrial base; and
- improving observance of ethical standards in government and industry.

January 10, 1990

DEFENSE MANAGEMENT REPORT INITIATIVES
SUMMARY OF ACTIONS TAKEN AND BUDGET IMPACT

DEFENSE MANAGEMENT REPORT: INITIAL ACTIONS TO ACHIEVE ITS OBJECTIVES

The Department of Defense is engaged in a sustained, long-term effort to streamline its management, with a special emphasis on Defense acquisition management. The first major installment of this effort is reflected in the actions taken to reduce management costs in the FY 1991 budget. These budget actions are in response to the President's call for DoD management improvements in his February 1989 address to Congress. Following the President's request for management improvement, the Department completed the Defense Management Report (DMR) in July 1989. It sets substantial dollar savings targets for management improvement beginning in FY 1991 and continuing at least through FY 1995.

Using the DMR as its guide, the Department has identified initiatives to save about $2.3 billion in FY 1991. Over a five year period, FY 1991-1995, the cumulative savings will be close to $39 billion, with corresponding reductions of 18,000 civilians, and 24,000 military. These savings through better management have made an important contribution towards reaching the President's budgetary goals, and will enable the Department to maintain greater military capabilities than would have been otherwise possible.

APPROACH TO MANAGEMENT IMPROVEMENTS

The Department's approach to the DMR has been a cooperative effort with the full participation of the Military Departments.

Improvements in technology have made many of the proposed changes possible.

DoD's approach to achieving DMR efficiencies emphasized the following:

- Develop management efficiencies that do not require force level or strategy changes.
- Maintain the level and improve the quality of management support, while reducing the costs.
- Use technology, including ADP systems and communications, to reduce costs.

- Increase the accountability of program managers by increasing the visibility of total program costs and by placing the costs of doing business under the control of people executing the programs.

- Use budget savings realized through management efficiencies to meet DoD's budget target.

- If, for other reasons, force level reductions are necessary, consider further reductions in the DoD management support structure and associated cost reductions.

- If reductions in personnel are necessary due to streamlining and consolidations, the first objective will be to achieve these reductions through attrition and early retirements. Displaced employees will be assisted in finding appropriate positions in the Department.

With these guidelines in mind, DoD has identified areas where management efficiencies will produce savings. Acquisition and logistics management were the primary focus of this effort because:

- The President charged DoD to fully implement the Packard Commission proposals; and those recommendations mainly addressed problems in acquisition and logistics.

- Acquisition and logistics management account for about one-third of the DoD budget.

- Management deficiencies identified by OMB, by the Inspector General, and in the DoD Annual Statement of Assurance suggest there is a high potential for management efficiency and cost reduction in these areas.

In addition, emphasis was given to other functional areas including:

- Administration

- Automated Support and Information Systems

- Finance, Procurement and Contract Management

- Consolidation Studies

In each of these functional areas, budget savings were sought through the use of management efficiency concepts including:

- Consolidating operations in support areas.

- Streamlining operations by eliminating unnecessary layering and redundant functions.

- Improving business operations through better systems and procedures.

- Reducing headquarters operations where such reductions can occur without impairment to management control.

A description of the Defense-wide issues and the results expected from actions in each of the functional areas follows. Service specific initiatives are described in the Service DMR Reports.

LOGISTICS

The Department spends approximately $30 billion a year managing the supply system, including the cost of supplies. The value of inventory on hand is approximately $100 billion and has been increasing annually. The logistics initiatives address the need for improvement of the supply system and reduced supply costs. Specific changes have been identified for supply management, distribution, transportation, and management of clothing and textiles.

It has become evident that the current policies and procedures have served to impede improved operations and may have increased the cost of doing business by not allowing the flexibility to make smart management decisions. In addition to the impediments institutionalized through policy, there is the problem that "stove-pipe thinking" has also become institutionalized. One of the major changes needed is a change in mind-sets. Supply managers must see and understand -- must have visibility -- of the costs of their operations and the willingness to make trade-off decisions to do what is in the best interest of the Department. A global perspective is required as DoD moves into the future.

- Materiel Management Costs in Stock Fund

  Funding of operational costs of materiel management and distribution will be moved to the Stock Funds and these costs will be reflected in the cost of materiel through the surcharges the Military Departments pay for materiel. This allows greater visibility of the actual cost of operation. It also allows managers greater flexibility in making decisions that may ultimately result in cost reductions by taking down some of the barriers between appropriations. It is envisioned that in at least some areas manpower requirements may be increased, but with an overall decrease in the cost of the materiel. For example, a supply center may find intensified value engineering, or materiel break-out efforts, could break sole source contracts and result in

decreased cost of materiel through increased competition. In a Supply Depot, more workyears in transportation may increase shipment consolidation, thus resulting in reduced costs.

The major cost factor is inventory, and a key to improved inventory management is increased visibility of assets. If the item manager can look into the retail, wholesale, and operating stocks, decisions to redistribute can be made rather than a decision for a new procurement. This reduces lead time, costs, and inventory levels. Systems changes are necessary to accomplish this change and are being programmed as DoD works toward a single logistics system.

- Improved Management of Repairables

This initiative transfers Army and Air Force funding of repairable parts from direct appropriations to the stock funds. This in turn will require users to pay for new repair items which in the past have been free issue and will give users an incentive to repair rather than purchase new items. The estimated savings are the result of reduced consumption due to users having the option to choose between repair or replacement. The Navy transferred the funding of these items to the stock fund in the early and middle eighties and realized a reduction in demand for repairable items. The savings for Army and Air Force reflect an expected decrease in demand. There is an additional benefit by providing the opportunity to reprogram between the various categories of cost because of having a single funding source for procurement and maintenance of repairables.

- Multi-Year Contracting

Policies are being changed to assist in changing the way DoD buys and manages. One of these provides obligational authority to permit multiple year contracts with guaranteed minimums. The idea behind this change is to move us toward just-in-time materiel management while building long-term relationships with contractors but not binding us from moving items to more favorable contracts as practical. Multiple year contracts can drastically reduce lead times that are very costly.

- Storage Location Policies

  Another policy affecting returns is the decision to retain returns at the closest depot to reduce handling and transportation costs. Ownership of the item will remain with the wholesale item manager and when an item is requisitioned, they will notify the holding depot to release the materiel. Another initiative that affects stocking policy is to allow the storage of materiel close to the vendor rather than the customer. In these times of overnight delivery, transportation can be efficiently managed and this initiative is expected to result in savings.

- Reducing Transportation Costs

  The Department spends $2 billion per year on transportation costs. Some of the innovations that have taken place in the private sector will be incorporated into DoD operations. This includes the establishment of regional freight consolidation centers that will operate much like the Federal Express hubs; modifying the priority system to ensure that only those items that are urgently required are shipped separately; shipping material directly from vendors to users and utilizing a "guaranteed traffic" program that includes competitive awards to carriers to provide scheduled movements on specific routes in return for reduced rates.

- Clothing and Textiles

  Clothing purchases for each of the next three years will be limited in order to reduce inventory growth. The purpose is to alter an unacceptable drain on DoD resources. That is, over the last few years, receipts from purchases have exceeded sales by approximately $500 million. Reducing sales by $80 million for each of the next three years will reverse the growth and be reflected in surcharge reductions in FY's 1992-1995.

  The policy for introducing new clothing items will be changed to require the Services to pay for purchases up front, thereby making customers more aware of the cost of adding new items to the inventory. Also, the Services will be encouraged to use commercial specifications, increase standardization, and reduce the number of clothing sizes. Finally, specification development for clothing items will be consolidated and centralized.

While a number of initiatives have been described for the logistics area, the main theme is improved efficiency and effectiveness. As expressed earlier, success is dependent on the degree which managers are willing to change. Increased visibility and understanding of all facets of logistics allow for better management decisions. Enhanced ability should provide positive reinforcement to all employees involved in this important business. Nothing is being tried that hasn't proven itself as a motivator for improvement.

ADMINISTRATION

The Packard Commission and the DMR both called for streamlining of headquarters operations and other efficiencies that lead to reductions in staff augmentation. A series of actions address those objectives.

- Streamlining the Defense Agencies and OSD Offices

  The Defense Agencies were asked by the Under Secretary of Defense (Acquisition) to seek management improvements and efficiencies. Defense Agencies will realize reductions through organizational changes, headquarters reductions, automation improvements and procurement efficiencies.

  Although the budget anticipates these savings will be made through personnel reductions, the Agencies were given the flexibility to implement alternative program reductions, if appropriate, which do not require corresponding end strength decreases.

  The DMR recommended streamlining the Office of the Secretary of Defense, and the budget will reflect personnel reductions. This decrease will be offset by transferring some billets into OSD which the Inspector General believes should be shown on OSD rolls rather than in Defense Agency totals.

- Reducing Costs of Civilian Personnel Services

  The Department has operated with a lower ratio of personnel staff to population served than most Federal Agencies. The decision reflected in the budget is that all Services should operate with the same ratio of personnel staffing to population being serviced. The Navy ratio is 1:61 and is the recommended mix. The Navy has adopted the "Manage to Payroll" philosophy which reduces centrally managed regulations and gives line managers more flexibility in their personnel management. By adopting a similar personnel management philosophy, the other Services can achieve similar savings.

- Industrial Funding Military Personnel Cost

  Military personnel costs have not previously been reflected in the cost to run industrial facilities, shipyards, ammunition plants, etc. In FY 1991, we will reflect military personnel costs to ensure visibility of these personnel expenses to managers.

- Civilianization of Military Spaces In Support Functions

  DoD will substitute civilian manpower for military manpower in positions which do not specifically require a military incumbent. On the average, a civilian work force is less costly than a military work force, and overhead support-type functions can be performed by civilians as opposed to military. These functions include installations management, management headquarters for support commands, research and development, training and personnel, joint activities, and support activities. The savings result from the conversion of about 20,000 positions over the five year period.

IMPROVING AUTOMATED MANAGEMENT INFORMATION SYSTEMS AND IMPLEMENTING CORPORATE INFORMATION MANAGEMENT

The Department of Defense has made a strong commitment to the improvement of the way it collects, uses and manages information that supports its business operations. The Department presently spends $9 billion annually on automated information systems that are essential to the management of the Department. DoD is committed to improving the standardization, quality and consistency of data from its multiple management information systems. Further, it is committed to adoption of single systems in each of the major functional areas of management.

Deputy Secretary Atwood developed a plan in response to the DMR mandate to improve support systems and to achieve needed improvements through implementation of a Corporate Information Management Program for DoD. This will involve calling on an executive level group of outside experts to help DoD develop the appropriate procedures and mechanisms for systems that are standardized and integrated and provide top management with useful, timely information on the business operations of the Department.

- Single DoD Business Information Systems

  DoD spends approximately $9 billion per year on information systems, of which approximately $4 billion is devoted to the development of new systems. A significant portion of the $4 billion is spent on developing Service-unique systems to meet essentially the same requirement. The Department has traditionally

had multiple management information systems performing the same or very similar functions in each Service and other organizational elements. Examples of these duplicate system developments are: payroll, warehousing, accounting, and supply management. Under this initiative, the development effort will gradually transition towards DoD-wide uniform systems. Teams of experts from the Military Services and OSD are being assembled in each of the functional areas to accomplish this objective.

- Computer Aided Logistics Support

  Computer aided logistics support (CALS) will allow the Department to accept digitized logistics technical information from weapon system contractors, using OSD-accepted standards, in digitized electronic format rather than hard copy. CALS will support the technical information needs of the Department and develop a network system architecture for interoperability of existing/emerging stand-alone technical information data bases currently used in DoD. The Navy has proposed ten separate initiatives of CALS that have the potential for improving the development, maintenance, and dissemination of logistics and design data, and have the potential for wider utilization in DoD. Acceleration of ongoing programs will achieve significant savings compared to currently funding levels.

FINANCE, PROCUREMENT AND CONTRACT MANAGEMENT

Both the financial and contract communities have recognized that further cost efficiencies and operational improvements can be achieved through the consolidation of like activities, the establishment and maintenance of control over valuable resources and property, and enhanced measurement and accountability for assets owned or contracted for by the Department. Economic benefits will be derived by more closely scrutinizing specific managerial oversight responsibilities related to financial monitoring, the consolidation of DoD contract management, and the use of consultants by DoD.

- Improved Accountability for Government Furnished Material

  Action has been taken to establish better control and accountability over Government Furnished Material (GFM). The primary initiative is the development of a financial management system, as part of the DoD financial management network, to record, monitor and account for the issuance of GFM to contractors. This system will employ traditional accounting principles and standards in a manner similar to other financial systems already in place as a control over issued materials. The system

would generate financial reconciliations and accountings which do not now exist. This accountability will force contractors to be more conscientious about the use of government furnished resources, discourage requests for material in excess of requirements, correlate materials issued with finished products, and enhance recovery of unused material.

- Reduction in Contracted Advisory and Assistance Services

  The Contracted Advisory and Assistance Services (CAAS) will establish better management controls over documentation, competition and approval of services provided by consultants in this area. The initiative focuses on new requirements to maintain control over funding provided to Federally Funded Research and Development Centers and DoD funding passing through to projects situated in and managed by the Department of Energy. The controls will provide more accurate reporting of consulting costs, both in the budget justifications and the Federal Procurement Data System. This action is also responsive to the congressional concern over DoD spending on CAAS and perceptions that DoD has grown too dependent on contractors to perform work that is more appropriately performed by the Department.

- Streamlining Contract Management

  The DMR called for the consolidation of all DoD contract administration services into a single organization. These services have been divided among the three Military Departments and the Defense Logistics Agency (DLA) for many years. This initiative provides for placement and consolidation of all those functions in DLA. Consolidation should make possible the elimination of differing procedures for management contracts now in existence among the four agencies handling contract administration. It should also enhance professionalism and increase the focus and attention on contract administration. It will also make it possible to present a single face to industry on all contract management issues.

IMPACT OF FY 1991 DECISIONS ON THE BUDGET

A number of initiatives will improve logistics systems and save $1.4 billion in FY 1991. Initiatives to streamline administrative functions are expected to save $.3 billion. Savings of $.3 billion are anticipated from ongoing studies to consolidate, establish executive agencies, and/or achieve greater efficiencies at various support activities, such as depots and laboratories, which are discussed further in the next section. Better control of procurements and contracts will save

$.2 billion, and better procedures for developing automated management information systems will save $.1 billion. Total savings reflected in the FY 1991 budget from the initiatives equal $2.3 billion.

In addition to these direct savings, the action previously discussed to improve management of repairable items will allow the Department to propose a reduction of $2.8 billion in budget authority in FY 1991 and a total of $10 billion over the 5-year period. This is because repairable items will be bought through the DoD stock fund accounts beginning in FY 1991 instead of through the procurement accounts. Since stock funds are revolving accounts that do not require annual appropriations to obligate funds, budget authority is not required to implement this policy change. Since this is largely a budget and accounting transaction, it has not been included as a part of our DMR savings package. It is an important management improvement because it requires managers to make cost conscious choices between repair or purchase of new items.

These initiatives will continue throughout the five year planning period and the cumulative savings from FY 1991 to FY 1995 are expected to be $39 billion.

FURTHER STUDIES/ANALYSES TO BE COMPLETED

The decisions taken in the preparation of the FY 1991 budget to reduce the costs of providing support services have made major management improvements and resulted in substantial dollar cuts. There are, however, a number of recommendations for future management actions which require further analysis prior to decision. In keeping with the guidance in the DMR that there must be a sustained, multi-year effort to streamline the Department's management, teams of experts are being assembled to give further study to proposals in many of the same functional areas where savings were taken in FY 1991, as well as in other areas.

These proposals appear to hold promise as a means to reduce DoD costs further without affecting military capability or reducing the level of support.

- Studies of Consolidation of Management Support Operations

  Study teams will be reviewing opportunities to achieve greater efficiencies through possible consolidations, management changes, and associated savings in the following areas:

  - Supply Depots Throughout DoD

    There are 33 supply depots in the DoD system operated by each of the three military departments

and by the Defense Logistics Agency, providing supplies to all elements of the Department. Exploring consolidation in a single service or agency may result in significant reductions in base and headquarters level overhead costs, systems development costs and better utilization of existing capacity

- Inventory Control Points Throughout DoD

The three Military Departments and the Defense Logistics Agency operate separate supply functions, managing about 5 million items valued at approximately $100 billion through 20 activities called Inventory Control Points. Of the 5 million items managed, 4 million are consumables, that is, items that would be used and disposed of when they have been used. Fu[illegible] savings in overhead, system support, mission, and [illegible]cilities costs could be achieved through consolidation, and/or other management efficiencies.

- Maintenance Depots Throughout DoD

The Army, Navy and Air Force all operate separate maintenance functions for the purposes of modification, maintenance and repair of ships, planes, tanks and other major items of equipment. Savings could be achieved in overhead reductions, closure of unneeded facilities and better oversight over maintenance operations through consolidations and/or other management efficiencies.

- Automated Management Information Systems Design Centers and Operations

The Department operates approximately 1,000 data processing installations, called information technology facilities. These facilities are engaged in software design, modification of systems, maintenance of systems, data processing operations, and administrative support. Additional cost reductions through more efficient central operations, better use of limited information technology resources and reduction in the number of staff needed are anticipated.

- Accounting Operations and Finance Centers Throughout DoD

There are four military pay systems and centers, dozens of accounting systems, and hundreds of accounting and finance stations throughout DoD. Operating savings could be realized by reducing the

numbers of systems, by a central streamlining of all accounting and finance operations. Such a move would greatly enhance the operation of a single accounting system for the Department. A decision to create such a single system was taken as part of the DMR budget process.

- Research and Development Laboratories and Test Facilities

  Each Military Department operates laboratories and test facilities. Nine facilities are engaged in work on guided missiles, 8 work on lasers, 15 on medical research, 8 on environmental issues and 6 on psychology research. Consolidation of some of these could reduce costs through reduction in overhead, streamlining operations and centralization of professional staff associated with specific areas of research and technology.

The study teams are to examine all options, challenge the present way of doing business, and make recommendations about what should be done to improve efficiency and reduce duplication. Reports from tne study teams are due by May 1 to the Deputy Secretary. As previously stated, another $300 million in savings can be captured in FY 1991 through implementation of recommendations made by these study teams.

- Development of Requirements For Standard Management Information Systems

  Beyond the consolidation studies, the Department has also now committed itself to a set of major developmental efforts aimed at changing fundamentally its approach to the deployment of major automated information systems used to support the Department's business operations. The Defense Management Report called for streamlining of the Department's business and management support activities. The Department has long had multiple management information systems performing the same or very similar functions in each Service and throughout other organizational elements of the Department. The success that industry has experienced in developing integrated management information systems and in eliminating redundancy indicates that much can be done in DoD to reduce costs now associated with multiple systems.

  The Department plans to eliminate multiple systems and to implement single systems to support major functional areas important to the sound management of the Department. This decision recognized that major improvements are needed in the standardization, quality

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and consistency of data produced by the Department's multiple management information systems.

In order to evaluate the depth of the problem in DoD and to give the Department guidance in developing corrective measures, an executive level group of outside experts and DoD officials has been established to recommend an overall approach for the Department and to assist in the development of a corporate information management program for the Department. The Department will begin work on the development of requirements for single systems during FY 1990 in six areas. These are:

- Civilian payroll
- Civilian personnel
- Financial management
- Warehousing
- Supply management
- Contract payment

The requirements for these six are to be developed by teams of experts over the next 18 to 24 months, with other areas to be selected in the future.

- Further DMR Management Efficiency Studies

The six analyses of possible consolidations and the six systems requirement analyses together represent a major commitment to a sustained, multi-year approach to improving management. In addition, the Department will engage in further analyses in the functional areas where emphasis has been placed thus far, and will actively search for still other management efficiencies throughout the Department. Those analyses will begin in January 1990, and will be completed in time for them to be incorporated as appropriate in the FY 1992 budget. This process will be repeated each year. The Department is committed to continuous improvement in management efficiency and effectiveness.

LEGISLATIVE PROPOSALS, REGULATORY, AND POLICY CHANGES

The maze of confusing and sometimes contradictory statues and regulations governing defense management is one of the most substantial barriers to improving management in DoD. Therefore, in addition to budget actions and planned studies/analyses, there will also a set of legislative proposals, being developed with OMB, to foster the goals of the Defense Management Report. These legislative proposals will involve such areas as production, acquisition and logistics, personnel, environment, and financial management.

DoD has begun a process to reduce the self-imposed burden of regulatory and policy guidance. Timely and favorable consideration by Congress of the proposed legislative changes will enable the Department to take a number of broad ranging actions which will produce economies and efficiencies in many functional areas.

Drawing from these initiatives, the Department seeks to encourage to revise the statutory framework governing Defense acquisition management to permit full implementation of the Defense Management Report.

DEPARTMENT OF THE ARMY
OFFICE OF THE SECRETARY OF THE ARMY
WASHINGTON, D.C. 20310-1600

11 JANUARY 1990

INFORMATION FOR MEMBERS OF CONGRESS:

> *"The quest for excellence in defense management will be successful only if a new management philosophy can replace the old."*
>
> - PACKARD COMMISSION

Given the challenge of the Defense Management Review (DMR), the Army responded by making changes in its organizational management and philosophy across the spectrum of its management responsibilities. These new azimuths have already allowed the Army to move forward to improve its management system and to more effectively manage its resources.

Our commitment to full implementation of the DMR initiatives is not tied to a single program or method, but encompasses a wide range of efforts networked to form a powerful system for change. The cumulative effect of these actions is a major institutional effort to enhance productivity and quality.

To meet the civilian personnel resource reductions for Fiscal Years 90 and 91, the Army plans to use only the least severe options, such as curtailment of TDY, overtime, and other discretionary spending, prior to instituting actions adversely affecting the pay or jobs of civilians. The use of a Reduction In Force (RIF) will be used only as a last resort to achieve long-term savings.

This paper will address three major areas:

- The Acquisition Management Structure
- The Army Acquisition Corps
- Management Initiatives

ACQUISITION MANAGEMENT STRUCTURE

> *". . . central to [the Packard Commission's] conception was the establishment of clear, abbreviated lines of authority within the Services for the performance of their traditional role in managing major programs."*
>
> - Defense Management Report

The Army began implementing the recommendations of the Packard Commission and the Goldwater-Nichols Act in January 1987. The Army Secretariat and Staff were reorganized to reduce layering and reduce the size of the Headquarter's Staff. The Office of the Comptroller of the Army was moved under the Assistant Secretary of the Army for Financial Management [ASA(FM)], the Assistant Secretary of the Army for Research, Development and Acquisition [ASA(RDA)] was bolstered by incorporating the Office of the Deputy Chief of Staff for Research, Development and Acquisition, and the Director of Information Systems for Command, Control, Communications and Computers was established to oversee information policy.

As the Army undertook to further improve upon what had already been done, it charted a course of acquisition structural and procedural changes to more efficiently and effectively run the business of the Army. Building upon the Packard Commission recommendations, the Army developed a three-tier reporting chain for program management consisting of the Army Acquisition Executive (AAE), Program Executive Officers (PEOs), and Project/Product Managers (PMs). These actions:

Established clear, abbreviated lines of authority

Removed unnecessary layers

Streamlined the decision process

ARMY ACQUISITION EXECUTIVE The Secretary of the Army appointed the first Army Acquisition Executive in March 1987, naming the Under Secretary of the Army as his hands-on, day-to-day acquisition representative. In May 1989, when the Under Secretary assumed collateral acquisition duties in the Office of the Under Secretary of Defense for Acquisition, the Secretary named the Assistant Secretary of the Army (Research, Development and Acquisition) [ASA(RDA)] as the AAE

and Senior Procurement Executive with full-time responsibility for acquisition functions. Upon the resignation of that official, the Secretary of the Army became the acting AAE until a new ASA(RDA) nominee is confirmed by Congress. Once this position is filled, it will again be designated as the full-time AAE.

PROGRAM EXECUTIVE OFFICERS At the same time the AAE position was created, the Program Executive Officer (PEO) structure was also established. These PEOs, both military and civilian, are selected by the Secretary of the Army based upon recommendations by the AAE in coordination with the Army Chief of Staff. These PEOs report directly to the AAE and oversee a number of individual programs that support related missions. For example, the PEO for Heavy Force Modernization oversees tank and fighting vehicle programs.

PROJECT/PRODUCT MANAGERS The third tier in the Army's acquisition management structure consists of Project and Product Managers (PMs). Responsible for managing the day-to-day acquisition activities of assigned systems or programs, PMs are charged with managing and executing the development, production, and fielding of a system in accordance with approved performance, schedule, and cost requirements.

PEO RESOURCE CONTROL

> *"... FUNDING AND PERSONNEL AUTHORIZATIONS FOR PEO OFFICES... WILL BE ADMINISTERED SEPARATELY FROM SERVICE COMMANDS."*
>
> - Defense Management Report

The Army is revising its resource support system structure for the PEOs to improve their control over the funding and manpower resources they need to carry out their responsibilities. With respect to both dollars and personnel authorizations, PEOs and subordinate PMs will draw their resources directly from HQDA rather than from the materiel commands. The materiel commands will continue to provide a variety of support services without duplicating any of the PEOs' or PMs' management functions. This enhanced resource control system will help ensure that PEO and PM managed programs operate as centers of excellence, managed with modern efficient techniques, without administrative burdens or materiel command layers being inserted into the chain of command.

THE ARMY ACQUISITION CORPS

". . . it is vitally important to enhance the quality of the defense acquisition workforce -- both by attracting qualified new personnel and by improving the training and motivation of current personnel."

- Packard Commission

The Army Acquisition Corps (AAC) addresses that portion of the Defense Management Review concerning development of a dedicated corps of acquisition specialists. In so doing it complies with Public Law 99-145 and proposed Department of Defense Directive 5000.52 which establish specialized training and development requirements for specific acquisition positions. These "critical positions" encompass specific military and civilian positions located in Program Executive Offices, Project/Product Management Offices, and selected support and staff positions in matrix support commands and headquarters offices. The AAC is composed of the military and civilian specialists occupying these positions as well as candidates being developed to compete for future assignment to them.

This initiative takes full advantage of the work already accomplished by the Logistics and Acquisition Management Program (LOGAMP), the Materiel Acquisition Management (MAM) Program, and the Acquisition Management Mission Cluster Group. It greatly improves upon these programs and, more importantly, fully integrates the military and civilian acquisition programs into one. This will be a Total Army program. A single office will manage the AAC, to include developmental efforts and assignments for both military and civilian personnel. The new acquisition program is designed to eliminate problems identified by prior studies of both the MAM and LOGAMP programs.

The AAC provides for the competitive selection of military and civilian candidates into a common developmental pool; develops them in accordance with Public Law and DoD guidance; and provides for competitive promotion, from within the pool, into critical positions. Mobility related to missions and development needs is a requirement for civilian as well as military personnel.

For the military community, officers will enter the AAC at their eighth year of service. Fully funded advanced civil schooling (ACS) will be offered to all future military participants for education in scientific, technical, and managerial disciplines. Selection for Command and Staff College (CSC), Defense Systems Management College (DSMC), and Senior Service College (SSC) will remain unchanged. Officers in the program will be groomed through acquisition developmental assignments. The corps of acquisition officers will not require battalion or brigade command experience, but will concentrate on critical acquisition management assignments. Promotion policy and guidance will be structured to ensure potential for advancement from company grade to flag rank.

For the civilian community, the corps will draw from existing civilian career programs at grades 13 and above. Those programs will have already provided much of the required specialized training and experience. As necessary, individuals will be further groomed through schooling and developmental assignments. Legislation is being recommended that would permit paying for degrees for civilians. Such legislation will offer advanced civil schooling to civilian personnel identical to what is now offered to military participants. In addition, brief orientation courses will provide civilian personnel with an improved materiel user perspective. Civilians will remain eligible to compete within their career program, but will focus more directly on acquisition opportunities. The civilian program will also provide for promotion opportunity from GS-13 through SES grades.

We are convinced this is the right direction for the Army to take in developing the leadership and expertise needed to successfully acquire materiel and weapon systems to meet Army requirements now and in the future.

MANAGEMENT INITIATIVES

> *" [Implementation of the Packard Commission recommendations] should allow for a substantial reduction in the total number of personnel in the defense acquisition system. . . ."*
>
> - Packard Commission

In addition to forming a professional Acquisition Corps and streamlining the acquisition management structure, the Army is considering a number of initiatives designed to meet the goals of the Defense Management Report.

STREAMLINE AMC The Army Materiel Command's mission has been and will continue to be performed in accordance with the streamlining and efficiency improvement objectives outlined by the Packard Commission and the DMR. For example, over 14,000 personnel spaces have already been cut from AMC's organizational structure over the past three years. Additional spaces will be removed as a result of DMR-related initiatives. This additional reduction can best be realized by capitalizing on the full range of efficiency and economy opportunities that exist within AMC. AMC Headquarters will no longer emphasize management of programs, projects, or commodities on an individual basis. Instead, it will focus on command and control, policy, planning, program integration, resource allocation, and performance evaluation relating to execution of its three primary missions: (1) providing logistical support; (2) managing programs other than those conducted under the PEO structure; and (3) providing a variety of support services to PEOs and PMs while duplicating none of their functions.

CONSOLIDATE ARMY LABORATORIES A study group is addressing various means to improve the quality of Army Labs and to enhance management efficiencies.

CONSOLIDATE ARMY TEST AND EVALUATION(T&E) The Army will study various means to enhance management efficiencies within its test and evaluation communities.

STREAMLINE CONTRACT ADMINISTRATION SERVICES (CAS) AT ARMY AMMUNITION PLANTS (AAP) This initiative will upgrade the quality of the workforce by providing a more efficient and effective organization dedicated to CAS functions at each AAP.

STREAMLINE INFORMATION SYSTEMS COMMAND (ISC) The elements of the Information Systems Command were reviewed to determine where efficiencies and savings may be obtained.

LOGISTICS SYSTEMS IMPROVEMENTS This includes consolidating selected wholesale and retail logistics functions; reducing inventory of outmoded major items and retention level stocks with no known requirements; reducing materiel returns and consolidating supply support for maintenance depot operations.

REDUCING SUPPLY SYSTEMS COSTS Savings are anticipated through reductions in spare and repair part inventory. The basic concept provides tools to wholesale level supply managers which improve visibility and control over the costs of buying, storing, and issuing stock fund items.

STOCK FUNDING OF REPARABLES This initiative includes the transfer of funding of reparables from direct appropriations to the Army Stock Fund.

REDUCE WHEELED VEHICLE SUPPORT COSTS This initiative removes numerous overage, overmileage and obsolete vehicles from the Army fleet. Savings will be experienced through reduction of operating and support costs.

REDUCE TRAVEL COSTS Travel costs will be significantly reduced; however, travel funds for recruiting, military student professional development and military schools and leasing of non-tactical vehicles used in tactical units will not be reduced.

CIVILIANIZATION OF MILITARY SPACES IN SUPPORT FUNCTIONS DOD will substitute civilian manpower for military in positions not specifically requiring a military incumbent. Generally, overhead support-type functions can be performed by civilians. These functions include

Installations Management, Management Headquarters for Support Commands, Research and Development, Training and Personnel, Joint Activities, and Support Activities. Also, civilians are less costly than military personnel.

STREAMLINING THE CIVILIAN PERSONNEL SYSTEM The Army will streamline its civilian personnel system and increase the ratio of personnel serviced, by delegating additional responsibilities to line managers.

STREAMLINING DEFENSE CONTRACT MANAGEMENT The DMR called for the consolidation of certain DOD Contract Administration Services (CAS) in a single organization. This initiative provides for the transfer of CAS at tank plants and Army Plant Representative Offices to DLA.

CONTRACTED ADVISORY AND ASSISTANCE SERVICES Efforts are being directed at: (1) expanding the visibility of Contracted Advisory and Assistance Services via the budget review process; (2) clarifying and refining definitions in this area; and (3) educating DOD managers, users and procurement personnel regarding documentation, approval and reporting requirements.

SINGLE DOD BUSINESS INFORMATION SYSTEMS The DOD will experience a reduction in the costs of business information systems as a result of eliminating redundant systems and streamlining functional requirements. DOD will establish standard ADP systems resulting in the long term, in a Corporate Information Management System for the DOD.

MOVING FROM LEASED SPACE ONTO MILITARY FACILITIES This initiative will require legislation to establish a revolving fund to finance renovation or construction of DOD on-base facilities to enable the movement of DOD activities from leased space to on-base facilities.

REDUCING TRANSPORTATION COSTS The Army will use 5 initiatives to cut military services' transportation budgets in FY91-95. They are: (1) Guaranteed Traffic Program; (2) Regional Freight Consolidation Centers; (3) Issue Priority Group (IPG) policy; (4) Direct shipments from vendors to users; and (5) Prepayment audits.

REDUCING ELECTRIC COSTS The Army will join with DOD in an attempt to obtain additional low-cost federally-owned hydroelectric power.

REDUCING THE COST OF CLOTHING AND TEXTILES The Army will participate with the other services, OSD, and DLA in a series of initiatives designed to reduce the cost of clothing and textiles. Among these initiatives are aggressive pursuit of commercial specifications and consolidation of specification development.

ACCOUNTING FOR GOVERNMENT FURNISHED MATERIAL (GFM) Accounting principles and standards as well as prudent financial management practices dictate government furnished material must be retained under continuous DOD accounting and financial management control.

CONVENTIONAL AMMO WORKING CAPITAL FUND (CAWCF) The Army will institute a stabilized rate policy for the CAWCF to prevent price changes from causing fluctuations in production rates during the year. The elimination of unnecessary fluctuations will provide for smoother, more economical rates of production, thereby lowering costs.

DMR CONSOLIDATION STUDIES OSD will establish study teams to review possible consolidations/streamlinings of: (1) Supply Depots; (2) Inventory Control Points; (3) Aeronautical Depot Maintenance; (4) Non-Aircraft Depot Maintenance; (5) ADP design and operations; (6) Accounting and Finance centers; and (7) R&D Labs and T&E facilities. Results of these studies will be available in May 1990.

PROVIDED BY:

Office, Chief of Legislative Liaison

DEPARTMENT OF THE NAVY

SUMMARY OF

PLANS FOR INITIAL IMPLEMENTATION

OF THE

DEFENSE MANAGEMENT REPORT

SUMMARY

On 13 July 1989, the Secretary of Defense released the Defense Management Report (DMR) to the DOD Components for implementation. The DMR required the Secretary of the Navy to submit plans not later than 1 October 1989 to the Secretary of Defense which provide for, among other things:

1. Establishment of a single Assistant Secretary of the Navy as the Service Acquisition Executive, with full-time responsibility for all Navy and Marine Corps acquisition functions.

2. Establishment of Program Executive Officers (PEOs) through whom the SAE will manage major acquisition programs, each (PEO) to have a small, separate staff organization and devote full-time attention to management of assigned programs and related technical resources. Refocus of the Navy Systems Commands and the Marine Corps Research, Development and Acquisition Command to provide necessary logistic support to the PEOs, manage programs other than those assigned to PEOs, and provide a variety of support services to PEOs and PMs without duplicating their management functions.

3. Establishment of a dedicated corps of officers in the Navy and Marine Corps who will make a full-time career as acquisition specialists.

On 17 July 1989, the Secretary of the Navy established the Department of the Navy Management Review Task Force to conduct DMR implementation planning within the Department of the Navy. The Task Force, comprised of more than 100 military and civilian personnel organized into six Working Groups, conducted detailed planning in accordance with the DMR and additional formal written guidance provided by the Secretary of the Navy. On 2 October 1989, the Secretary of the Navy approved the plans recommended by the Task Force and forwarded them to the Secretary of Defense. The Secretary of Defense has approved the plans.

The principal findings and changes contained in the plans as approved are summarized as follows:

SECRETARIAT REORGANIZATION

At present, the Secretary of the Navy serves as the Senior Acquisition Executive (SAE) for the DON, and is the single office or entity designated under 10 U.S.C. 5014 to conduct the acquisition function within the headquarters elements of the DON. Within the Navy Secretariat, the NAE is assisted in doing so by the Assistant Secretaries of the Navy for Research, Engineering and Systems (ASN(RE&S)), and Shipbuilding and Logistics (ASN(S&L)), and their staffs.

This organizational arrangement has been criticized by the General Accounting Office upon the ground that the assignment of substantial responsibility to the ASNs RE&S and S&L does not comport with the requirement of 10 U.S.C. 5014 that a single office or entity within the Navy Secretariat conduct the acquisition function. The DMR provided a basis for resolving this concern, by requiring that a single Assistant Secretary of the Navy be designated the SAE. Upon review of 10 U.S.C. 5014, the Secretary of the Navy determined that in order to comply with both the statute and the DMR, it would be necessary to establish a

single Assistant Secretary of the Navy with sole responsibility within the headquarters elements of the DON for conduct of the research and development and acquisition functions, less matters pertaining to military requirements and test and evaluation which have been delegated to the Chief of Naval Operations (CNO) and the Commandant of the Marine Corps (CMC).

The Secretary of the Navy further determined to address certain other issues in the course of the necessary reorganization:

-- Consolidation of responsibility for automated data processing (ADP) acquisition under the ASN(RD&A).

-- Coordination of international acquisition matters.

-- Establishment of a single special Secretariat focal point for all aspects of antisubmarine warfare research, development and acquisition.

-- Establishment of the Under Secretary of the Navy as the focal point within the Secretariat for Total Quality Management initiatives.

Assistant Secretary of the Navy (Research, Development and Acquisition)

This plan will disestablish the ASN(RE&S) and ASN(S&L), and consolidate responsibility for all aspects of the research and development, acquisition and information resources management functions under a single Assistant Secretary of the Navy for Research, Development and Acquisition (ASN(RD&A)). Within the office of the ASN(RD&A), the plan

-- Designates the ASN(RD&A) as the Navy Acquisition Executive, Navy Senior Procurement Executive, and Senior DON Information Resource Management Official.

-- Provides a streamlined chain of command directly from the ASN(RD&A) through Program Executive Officers (PEOs) for assigned major acquisition programs (or SYSCOM Commanders for programs under their cognizance) to acquisition Program Managers.

-- Transfers the information resource management function from the ASN (Financial Management) to the new ASN(RD&A).

-- Clarifies the responsibilities of the Chief of Naval Research for policy and oversight pertaining to 6.1, 6.2 and 6.3A funds, Corporate Laboratories and Navy R&D Centers.

-- Consolidates responsibility for international aspects of research, development and acquisition programs under the ASN(RD&A).

-- Establishes a single Directorate for Antisubmarine Warfare as a focal point for all aspects of research, development and acquisition of antisubmarine warfare and undersea surveillance systems.

-- Establishes a Director for Acquisition Workforce Education and Training to coordinate and oversee planned enhancements of DON military and civilian acquisition professional programs reporting to the ASN(RD&A).

Assistant Secretary of the Navy (installations and Environment)

The plan will also establish an Assistant Secretary of the Navy for Installations and Environment, with policy and oversight responsibility for Navy and Marine Corps installations, facilities, safety, environmental affairs and shore resources management.

Total Quality Management

Finally, the plan will establish the Under Secretary of the Navy as the focal point for Total Quality Management leadership within the Department.

Streamlining of Secretariat Oversight

The plan to disestablish the ASNs (RE&S) and (S&L), and establishment of the ASN (RD&A) and (I&E) reflects a significant consolidation and streamlining of Secretariat oversight of the acquisition process. The plan eliminates duplicative efforts previously performed both within the two Secretariat acquisition organizations, and between the Secretariat and the Office of the Chief of Naval Operations (OP-098). Moreover, the plan reflects additional personnel savings as a result of the Secretary of the Navy's decisions to empower the cognizant PEO or Systems Commander to approve acquisition plans for all assigned programs, and to empower the cognizant Head of Contracting Activity (HCA) to approve business clearances for major programs, without routine prior review by advocacy and other offices within the Secretariat. These consolidation and streamlining actions are consistent with the DMR's emphasis on vesting PEOs/SYSCOM Commanders and Program Managers with full authority and accountability for cost, schedule and performance of their programs.

As a consequence of these consolidation and streamlining actions, the plan proposes a reduction in the current Secretariat-level staff actually devoted to the acquisition function from 270 to 208, a 23% decrease, and a reduction in the personnel currently devoted to the functions to be assigned the ASN(RD&A), ASN(I&E) and the Under Secretary from 305 to 253, a decrease of 17%. The Task Force report reflects the view of a majority of the members of the Secretariat and PEO-SYSCOM Working Groups that further substantial reductions will be achievable in the light of experience with the new Secretariat organization, and the plan challenges the new ASN(RD&A) to identify additional reduction and streamlining opportunities during the initial period of implementation.

PEO AND SYSCOM REORGANIZATION

At present, major acquisition and other weapons programs are executed within the DON by and through five major commands:

- Commander, Naval Sea Systems Command (NAVSEA)
- Commander, Naval Air Systems Command (NAVAIR)
- Commander, Space and Naval Warfare Systems Command (SPAWAR)
- Director, Strategic Systems Program Office (SSPO)

-- Commanding General, Marine Corps Research, Development and Acquisition Command (MCRDAC)

These Commanders serve as Program Executive Officers for assigned major programs, reporting for this purpose to the Service Acquisition Executive. The Commanders, Naval Supply Systems Command (NAVSUP) and Naval Facilities and Engineering Command (NAVFAC) also have significant responsibilities for acquisition of property and services other than weapons systems.

Since the abolition of the Naval Material Command in 1985, these commands have reported to the Service Acquisition Executive directly, with no intervening or collateral four-star acquisition or logistics command. Indeed, the Department of the Navy has heretofore implemented the Packard Commission's recommendations regarding a streamlined, three-tier acquisition reporting chain for major programs (SAE-PEO-PM) by designating these commanders as the Navy and Marine Corps PEOs.

However, the DMR requires that PEOs be established and administered separately from Service System Commands, and that PEOs report directly to the SAE on all matters of cost, schedule and performance regarding assigned programs. Accordingly, the plan provides for establishment of 7 PEOs and 3 Direct Reporting Program Managers, as follows:

-- PEO for Tactical Aircraft Programs

-- PEO for Antisubmarine Warfare Aircraft and Other Systems

-- PEO for Cruise Missile and Unmanned Air Vehicle Programs

-- PEO for Submarine Weapons and Combat Systems

-- PEO for Surface Antisubmarine Warfare Systems

-- PEO for Space, Communications and Sensors

-- PEO for Expeditionary Force Programs

-- Direct Reporting PM for Strategic Systems

-- Direct Reporting PM for AEGIS

-- Direct Reporting PM for SSN-21

Under the literal terms of the DMR, all of the 51 major (Acquisition Category (ACAT) I) programs managed by the Department of the Navy would be required to be transferred from the cognizance of the Systems Commanders to a PEO or Direct Reporting PM. However, it is equally clear under the DMR that the Systems Commands are to retain responsibility for logistics and life-cycle support of all acquisition programs, including those assigned to a PEO or Direct Reporting PM. These matters predominate once a system has reached mature, stable production. At the same time, elements of program risk which most strongly warrant intensive management of a system through a PEO or Direct Reporting PM are generally associated with development, not production. Finally, span of control concerns, the need to minimize redundancies in management structures, and other

considerations counsel creation of the minimum number of PEOs and Direct Reporting PMs necessary to implement the DMR principles of intensive, full-time, streamlined management of the high-dollar risk attendant to major development programs.

For these reasons, the Task Force recommended, and the plan provides that the Systems Commands retain PEO responsibility for certain ACAT I programs which are in mature, stable production; are not subject to any planned major block upgrades; and which do not presently involve any substantial matters of controversy or significant Defense Acquisition Board (DAB) issues. Accordingly, the plan provides for transfer of 30 of the 51 Navy and Marine Corps major programs to PEOs or Direct Reporting PMs, and retention of the remainder within the cognizant Systems Command. The bulk of the programs proposed for retention within the Systems Command are shipbuilding programs involving mature, stable designs. Retention of the ACAT I programs proposed within Systems Command cognizance is subject to case-by-case review and approval by the Under Secretary of Defense for Acquisition. This review will be completed as a matter of implementation of the plan.

At the same time, the Task Force identified a limited number of nonmajor acquisition programs which are integral to the success of major programs proposed for assignment to a PEO or Direct Reporting PM, and will therefore be transferred from SYSCOM cognizance along with their associated major program. An example is the MK-50 Engine Upgrade Program, which is plainly critical to the ACAT I MK-50 Torpedo Program itself.

Accordingly, the plan provides for transfer of a total of 78 (30 major and 48 related nonmajor) programs, valued at more than $19 billion, to PEOs or Direct Reporting PMs. Approximately 1500 program personnel will be reassigned from the System Commands to the new PEO and Direct Reporting PM organizations.

The plan prescribes a notional PEO organization in which the PEO is assisted by a staff of from 10 to 16 persons, providing the PEO direct support in four areas considered essential to the exercise of authority and accountability for cost, schedule and performance of assigned programs: technical management; configuration and logistics management; acquisition management; and business and financial management. PEOs and their assigned PMs will receive other support, including legal, contracting and matrix engineering support, from their supporting Systems Command as provided by Memoranda of Understanding or Agreement (MOU/A).

THE ACQUISITION WORKFORCE

The Department of the Navy's senior acquisition workforce is comprised of both civilians and military officers, and has a substantially higher proportion of civilians in key positions within the Secretariat and the Systems Commands than is the case in the other Military Departments. Military officers assigned to important acquisition positions are generally drawn from one of the following communities, depending upon the expertise desired:

-- Engineering Duty (Restricted Line) (ED)

-- Aviation Engineering Duty (Restricted Line) (AED)

-- Supply Corps (SC)

-- Civil Engineer Corps (CEC)

-- Unrestricted Line Materiel Professionals (MP)

-- Weapon System Acquisition Mangers (WSAM) [Not really a community, but a program which draws upon all communities.]

The Marine Corps presently identifies officers deemed qualified for acquisition management positions by means of an additional Military Occupational Specialty (MOS) as an Acquisition Management Officer (AMO). However, there are no specific education, training or experience requirements for designation as an AMO other then primary MOS qualification, completion of the appropriate prerequisite training at the Defense Systems Management College, and on-the-job training.

The DMR requires each Service to establish a dedicated military acquisition corps of officers. Participating officers would be identified not later than 10 to 12 years of service, and would thereafter devote themselves exclusively to a specialization in acquisition.

The Task Force reviewed career management within each community, and determined that ED, AED, SC and CEC officers are presently managed in a manner which fulfills the specialization requirement of the DMR. With respect to the Unrestricted Line, the Task Force determined that the existing URL Material Professional Program does not comply with the terms and purpose of the DMR, primarily because it permits designation as an MP at the O-6 (Navy Captain/Marine Colonel) level without firm requirements for prior acquisition experience. Nor does the WSAM Program, because WSAM officers are not managed intensively to develop acquisition experience. For the same reasons, the Marine Corps AMO Program does not comply.

At the same time, the Task Force determined that the recent operational experience and current knowledge of fleet and Fleet Marine Force requirements possessed by current MP and AM officers is an invaluable and critical perspective in successful program management. In order to fulfill the DMR's purpose of assuring that military officers possess sufficient acquisition expertise prior to assuming key acquisition positions, and at the same time preserve the invaluable "user" perspective which can only be derived through direct experience, the Task Force proposed, and the plan provides for, the identification of URL officers for specialization in acquisition earlier than the 10 to 12 year point. The plan assures at least eight years of intensive acquisition education and experience prior to assignment to key acquisition billets, and permits continued assignment to identified acquisition-related operational tours -- including command -- through the O-5 (Navy Commander/Marine Lieutenant Colonel) level.

The plan strengthens the existing Navy MP and Marine Corps AM programs in seven major respects:

-- The plan requires 8 years of acquisition education and experience prior to assignment to key acquisition positions. The current MP and AM programs require no specific acquisition management experience prior to designation as a MP or AMO and assignment to key acquisition assignments.

-- In the plan, all shore duty after designation as an acquisition specialist must be in acquisition training or acquisition billets. As currently structured, shore duty for prospective MPs and AMOs need not be related to acquisition.

-- The plan requires a Masters degree or equivalent in a technical or acquisition management field. Test pilot school, which is primarily Aeronautical Engineering, and Nuclear Power training are under consideration for equivalency. Post-graduate education is not now required for designation as a MP or AMO.

-- The plan requires the Defense Systems Management College (DSMC) Program Management Course prior to assignment to all key acquisition management jobs. Currently the DSMC course is only required prior to assignment as a Major Program Manager.

-- Under the planned program, exclusive assignment to acquisition billets ashore for the remainder of a career will occur at the senior Commander/Lieutenant Colonel level. Dedication to acquisition jobs will occur earlier for most URL-MPs than in the current program. The only current MP billets are at the Captain and Flag ranks.

-- The plan provides for selection of MPs/AMOs following initial warfare qualification between 4 and 12 years of service. Currently Navy MPs are selected following qualification for command as Commanders and serve in the their first MP billet as Captains following their command tour.

-- The management of an officer's career would be focused on acquisition from initial selection as an MP/AMO at the rank of Lieutenant or Lieutenant Commander vice completion of a command tour under the current MP program. For example, operational assignments can be managed to emphasize new construction and maintenance-related operational experience in platforms in which the officer will become an acquisition manager.

Civilian Workforce Initiatives

Although the DMR requirements address only the military acquisition workforce, balance in the development of the total workforce within the Department of the Navy requires attention to the civilian workforce as well. Accordingly, the Secretary of the Navy directed the Task Force to prepare a plan to strengthen the professional development of our civilian workforce as well. The plan proposed builds upon the existing Civilian Material Professional (CMP) program, but substantially strengthens it in the following respects:

-- Commands managing acquisition category (ACAT) programs or significantly influencing them are required to establish CMP programs and identify their key acquisition positions. Those positions are to be filled by CMP-certified employees, except in very unusual cases.

-- Competitive selection into CMP candidate programs is required

--- Candidacy will be limited to GM-13s and above,

--- Level 4 performance rating or higher will be required to be selected as a CMP candidate.

-- Requirements for certification as a Civilian Material Professional will be:

--- Eight years acquisition experience, at least two of which are in a procurement command

--- Bachelor's degree

--- DSMC Program Management Course, or equivalent

--- Three three-month rotations prior to certification

--- 80 hours supervisory training

--- 160 hours management development training

--- Two most recent performance ratings at level 4 or higher

-- Commands are to establish advanced development programs for selected certified CMPs. These programs will provide experiences such as extensive rotations, graduate level education, and training in senior service schools. Employees in these programs will be those anticipated to fill the most senior acquisition management positions including potential for major PM/PEO.

SECRETARY OF THE AIR FORCE
WASHINGTON

January 11, 1990

INFORMATION FOR MEMBERS OF CONGRESS

AIR FORCE DEFENSE MANAGEMENT REVIEW PROGRESS REPORT

There are two distinctive features to DMR in the Air Force. The first is its scope. From the outset, our goal has been to apply the spirit of DMR - finding smarter, streamlined, more cost-effective ways of doing business - across the spectrum of Air Force management activities. The second is its emphasis. We stressed that DMR was not a budget exercise. Our focus was on generating ideas with no specific dollar goals assumed or assigned at the outset. DMR is an open invitation to the people of the Air Force to help the Air Force surface innovative approaches to make more effective use of Air Force resources.

Initiatives generated by the "top-to-bottom" approach established in support of DMR will produce higher effectiveness, efficiencies and savings across the Air Force. Approaches include reduced training costs, reduced maintenance costs, creating a new acquisition structure and related procurement structure to more clearly define lines of authority and responsibility, restructuring major air command staffs, restructuring functions and staffs in the Air Staff and the Secretariat, and major streamlining of overhead and functional support within our acquisition commands.

Despite the potential both for cynicism about "one more" management program and for resistance to the major changes implicit in DMR, the principal reason for the quality and quantity of the inputs we received is that the Air Force community has recognized DMR as an idea whose time has come. Senior civilian and military Air Force leaders have strongly endorsed support of DMR and actively participated in implementation. Participation from field commands, the Air Staff, and the Secretariat have produced well over 500 proposals. The Secretary of the Air Force and the Chief of Staff "primed the pump" with direction to examine several specific areas where functions might be streamlined, consolidated, or eliminated. And finally, the Air Force, at all levels clearly understands that the alternative to implementing efficiencies is even more drastic reductions in force structure and modernization. In the on-going budget process, the savings from these efficiencies will help us meet our obligations in a constrained fiscal environment.

Taskings, Decisions, and Savings

We addressed taskings in three general categories. Specific tasks were listed in the Secretary of Defense's Report to the President and focus on acquisition matters. Collateral tasks for the Air Force are associated with support to DoD task forces working on specific tasks called out in the DMR. The third category is derived tasks -- those oriented towards management efficiency and streamlining outside the defined acquisition area. Air Force decisions to date have initiated implementation of more than 75 initiatives, and all have been considered under the National Environmental Policy Act (NEPA). Most of these proposals consist of budgetary, manpower, or internal organizational changes with little environmental implications. We determined that they qualified for one or more of the Air Force's categorical exclusions. A limited number of these proposals, however, will require further environmental analysis before final decisions can be made. We intend to pursue these proposals contingent upon the outcomes of the environmental process.

It is also clear that the success of many of the initiatives depends on factors external to the Air Force. Strong support from DoD will be critical in dealing with other government agencies, the Congress, and with our allies. Specifically, some proposals will ultimately require Congressional approval and consultation with allies. A coordinated plan of Congressional and host nation notification and public release will be essential.

Although improvements in the acquisition area should lead to significant cost avoidance, we will draw from the derived tasks to accomplish the specific dollar savings called for in the DMR. Some initiatives leading to longer term savings will require upfront investment. However, these one-time, upfront costs are allowed for in our plans and the anticipated net savings identified to date are substantial. Initiatives are under continuing review and will be resolved in the course of future budget and program cycles.

The Review Structure

We established a small Executive Group with the authority to oversee all Air Force activities in support of DMR. Co-chairs are the Under Secretary and Vice Chief of Staff. A set of panels and task forces, reporting to the Executive Group, examined the individual proposals and issues. Separate panels in the acquisition-specific area covered acquisition structure, acquisition management, acquisition career development, acquisition policy and resource allocation, and procurement policy. Panels dealing with

issues other than acquisition activities included logistics structure/policy, resource allocation, organizational streamlining, force structure, and personnel policy. Three separate task forces addressed Air Force Systems Command/Air Force Logistics Command (AFSC/AFLC) restructuring, Air Force Communication Command (AFCC) streamlining, and Air Staff/Secretariat restructuring.

The Executive Group continues to track implementation of acquisition specific tasks and the "pump primers", assign responsibilities and due dates for review of inputs from the commands, Air Staff, and Secretariat, and provide first order sifting and assessment. The Secretary of the Air Force and the Chief of Staff then evaluate the proposals and choose the most promising initiatives.

In consonance with the overall streamlining called for by the DMP, we are also examining our financial management functions and structure to eliminate duplication and overlap and to fix responsibility. All elements of financial management (budget formulation, review, enactment, cost, accounting and finance) are being reviewed carefully, both for short-term and longer term improvements.

Restructure of the Air Staff/Secretariat

The Air Staff and Secretariat are receiving close scrutiny as a part of the process. Pursuant to legislative requirements and the DMR principles, the Air Force has already implemented some changes in our headquarters. The Office of the Assistant Secretary for Financial Management has been established with a strengthened charter and consolidation of financial functions that had been spread among other headquarters offices. To improve the quality of staff work supporting the Chief and the Secretary and to better integrate the Secretariat and the Air Staff, we have formed the Air Force Council, Air Force Board, and Program Review Committees with appropriate level membership from both Secretariat and Air Staff offices. These changes should make our headquarters staff work and PPBS processes more effective by integrating the work of military and civilian staffs, as well as ensure that our guidance and tasking to the field is better coordinated and consistent.

Specific Tasks

Acquisition Structure

The Assistant Secretary of the Air Force for Acquisition will continue to be the Service Acquisition Executive (SAE) and have responsibility for all Service acquisition functions.

For major programs and selected others, responsibility and program management authority flows directly from the SAE to the

Program Executive Officers (PEOs) to Program Managers (PMs). PEOs will have no other responsibilities and will report to no one on program management outside the SAE/PEO chain. For other than major and selected programs, AFSC Product Division and ALC Commanders are responsible for overseeing program management. Responsibility flows directly from the SAE to them. The SAE may designate special interest programs as Executive Programs and include those programs in the direct chain. When so designated, oversight and reporting requirements are the same as for major programs.

AFSC and AFLC Commanders continue to be responsible for planning all required support throughout the life of all programs. These Commanders will recommend, for SAE approval, major program assignments to a PEO and coordinate with the SAE on other program assignments. AFSC/CC and AFLC/CC will be directly responsible to the SAE for support to PEOs and PMs. The quality and availability of support to PEOs and PMs will assure that SPO staffs remain as small and efficient as possible.

The key to the major systems acquisition structure is the PEO. We will establish the PEO as a senior operating official with the authority, responsibility, and accountability for a portfolio of related programs. The PEO is to be a planner of corporate strategies and objectives, a problem-solving team leader supported by acquisition commands.

We will carefully monitor the implementation of these changes and continue to fine-tune assignments and responsibilities as needed to ensure full compliance with the spirit and intent of the DMR.

Contracting Authority

Although the issue of contracting authority was not a specific DMR task, it is integral to the overall acquisition process. We have aligned contracting authority so that the procurement structure meshes with the acquisition structure. The Service Acquisition Executive (SAE) is also the Senior Procurement Executive (SPE). The SPE retains HCA (Head of Contracting Activity) authority for major and other programs. The SPE will delegate HCA authority to major commands for other contracting and delegate substantial authority for major programs through the PEO to the program office. Contracting strategy, planning, and contract clearance will be provided as a service for the SPE and PEOs by the acquisition command headquarters consistent with thresholds specified by the SPE.

This structure will allow optimum use of current contracting expertise, avoid layered or new staffs, and ensure consistency on strategy and reviews, while keeping the contracting authority for programs closely aligned with the SAE/PEO/PM structure.

Restructure of the Acquisition Commands

Air Force Systems Command (AFSC) and Air Force Logistics Command (AFLC) have developed streamlining plans that would, over time, significantly reduce their manpower. Both commands have recognized that their activities are fundamentally business operations that need not copy the hierarchical structures of operational military commands. They have adopted the philosophy that authority and responsibility should be vested at the lowest reasonable level and all staffs and functional oversight above that level must be justified on the basis of value added.

AFSC actions include headquarters reductions, consolidations, streamlining SPOs and various functional support activities. In AFLC, actions include headquarters consolidations and reductions, elimination of certain middle management structures, redesigning processes, streamlining reporting structures, exploiting automation of information, merging certain support functions, and consolidating functional organizations into line operating organizations. The number of entities reporting to the AFLC Commander is reduced from 50 to 22. In both commands, reductions will be phased to avoid RIF actions, relying instead on hiring freezes, early retirements, and similar measures. The commands are proceeding with detailed implementation plans.

Air Force Communications Command (AFCC), because it has acquisition responsibilities, was also examined. Our review of AFCC for acquisition streamlining continues, but in other areas, major decisions are already being made. AFCC has identified potential manpower savings. Some of the savings will come from technology applications at the base level that will enhance equipment reliability and allow us to eliminate the traditional division of labor between operations and maintenance. Other savings will come from combining or eliminating headquarters and intermediate staff functions, dissolving special communications teams or having operating activities absorb them, and colocating test, integration, and interoperability functions.

Acquisition Professional Development

In constructing the development program for the dedicated acquisition corps, we assured proper use of existing programs, identified needed new programs, increased the emphasis on education and training, and made the career paths compatible for both military and civilian specialists. The career paths have initial, middle, and senior levels, with the requirements for training, length of service, and acquisition experience identified in each path. A new pipeline course of approximately four months is to be part of initial level training for military specialists. Career

paths are provided for rated and non-rated officers in the acquisition corps. The requirement that non-rated acquisition officers have an operational tour and a flow of rated officers into acquisition will infuse user perspective into our program offices and acquisition system.

In the area of education, we recommend continuing DSMC for program management personnel. For DSMC attendees, ISS normally would be accomplished by correspondence. Graduate degrees for acquisition personnel will be emphasized and the Education with Industry Program reviewed for expansion.

Career development for individuals in the acquisition corps will be closely tracked to ensure objectives of the career model are met. We will establish a Professional Development Council to provide policy oversight.

Collateral Tasks

We appreciate the opportunity to participate in the work of the OSD Task Forces, and in the case of the Marsh Task Force, to chair the subgroup on Production, Logistics, and Acquisition. The Secretary felt it would be useful, in addition to the participation of the Air Force representatives, to comment on several of the issues addressed.

Joint OSD-DoD Component DCMA Task Force

The Air Force has supported the Task Force with substantial numbers of skilled contract administration personnel. We support consolidation of Contract Administration. The Air Force will continue to streamline the organizations that DLA will subsume, and we consider the reductions we make to be Air Force DMR savings.

Regulatory Review

The Air Force strongly supports the effort of the DoD Regulatory Task Force to streamline contract clauses and reduce the amount of lower level contracting guidance. Internally, we have found that Air Force acquisition policy outside the procurement area is scattered throughout regulations, policy letters, and pamphlets that are sometimes contradictory, overlapping, or outdated. Each OPR is reviewing the policies in its area of responsibility to consolidate guidance, and where appropriate, eliminate it. The guidance remaining after the review will be forwarded for use in the new DoD acquisition regulation series. Where appropriate, we will pipeline streamlined OSD acquisition regulations to our operating levels.

Acquisition Management Review

DAB Streamlining

The DAB process must be restructured to a foundation of accountability, trust, and timely decisions. The primary focus of the DAB, after reducing the number of committees and membership on each, must be on value-added acquisition oversight. We have streamlined our own processes by eliminating the Air Force Board/Air Force Council review prior to the AFSARC. The Acquisition Decision Memorandum preparation/signature procedures must include specific exit criteria for the next milestone and eliminate duplicate cost and supportability reviews.

Automated Information Systems

The Major Automated Information Systems Review Council (MAISRC) has been integrated with the DAB, and the $25M (one year)/$100M (total) threshold for major AIS retained. We will consolidate the Air Force Automated Information Systems Acquisition Review Council (AISARC) into the AFSARC. To insure each AIS receives management and oversight consistent with its type, application and complexity, the SAE should determine at Milestone I whether the full SAE-PEO-PM management structure should be imposed on AIS which fall below the major AIS thresholds of $25M/$100M.

Acquisition Policy and Resource Allocation

Acquisition Reporting Requirements

The procedures for collecting, compiling, formatting, and delivering various acquisition reports are labor intensive, time consuming, and leave little time for analysis. Many contain redundant data and are not useful for decision-making. We need to control the number and content of the reports. We also need to streamline the methods to collect and set common data bases to consolidate, analyze and distribute data. We will also investigate alternatives to incorporate functional-type reports that contain data similar to the SARs into DOD's Consolidated Automated Reporting System (CARS).

Derived Tasks

We are deriving significant benefits from broadening DMR to apply it throughout the Air Force. The effect on attitudes is perhaps more important than the specific proposals. The DMR is now seen as a tool to promote efficiencies across the spectrum of Air Force activities. Said another way, people all over the Air Force want to work more effectively to get the job done. It is this attitude of constructive pruning of the underbrush, as well as the initiatives themselves, that we are trying to derive from DMR.

Ethics

The Air Force is participating in the DoD Ethics Council and the dialogue on ethics issues with DoD. The need for all personnel to adhere to the highest standards of ethical behavior is a matter stressed at all levels. Ethics is both a command and personal responsibility. In the Secretariat and Air Staff, the General Counsel and Judge Advocate General have programs to provide information and advice on standards of conduct. In the field, commanders are charged with the education and training of both military members and civilian employees. In addition to initial briefings, all persons must be given a reminder about their standards of conduct responsibilities at least annually. Officers and employees separating from the service are counselled on post-employment restrictions, and major commands are encouraged to implement conflict of interest sensitivity programs. In the acquisition commands, because of the potential for conflict and the issue of public trust, standards of conduct is a matter of particular emphasis. AFSC has developed the "Straight Arrow" program, while the program in AFLC is known as PACER TIE (Trust, Integrity and Ethics). Each command's program meets its needs and supports the Air Force-wide policy of fostering the highest ethical and professional standards.

The Future

We have many promising initiatives and suggestions still under review. Additional ideas will be worked into the FY 92 POM process. We believe the potential for additional savings is substantial.

While the Executive Group will need to function as the Air Force's chief DMR entity for some period of time, we will begin to integrate DMR principles into the permanent Air Force structure and decision processes to best assure the continuation of its philosophy.

In the Air Force, DMR is a commitment to excellence in our institution.